TRENDS AND COMPOSITION OF INDIA'S INTERNAL DEBT SINCE 1971

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Dedicated
to my
Parents

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CERTIFICATE

This is to certify that Mr. Md. Suhail Khan has completed his M.Phil. dissertation on **"Trends and Composition of India's Internal Debt since 1971"** under my supervision. I find the work fit to submit for the evaluation.

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(MD. SUHAIL KHAN)

Aligarh

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C H A P T E R-I

I N T R O D U C T I O N

India adopted the planning for the economic development of the nation since independence. The budgetary policy plays very vital role in the process of economic development as being the mixed economy where public sector constitutes a major part of the whole economy. The govt. needed an anormous funds to start development project and to promote better standard of living to the people. Govt. has been directly participating in the production and supply of economic goods on the one hand and has been providing necessary infrastructur to the economy. There has been a financial constraints on the govt. due to its greater involvement in the economy. The mai thrust has been upon alleviation of unemployment and poverty i the country.

There are three major items in the govt. receipts of the budget - tax receipts, non-tax receipts and borrowing. Whenever there is excess of expenditure over receipts the govt. resort the policy of borrowing. Due to this fact the gross fiscal deficit (G.F.D.) that reflects the gap between the total revenue and the total expenditure of the govt.has increased to 9% of G.D.P. in 1986-87. The fiscal deficit though has been declining continuously since 1991 and it accounted 5% of G.D.P. in 1996-97. The gross fiscal deficit that is a broadest indicator of fiscal discipline has been closely monitered by I.M.F. and world bank agencies for several years. The govt. of India remained very much dependent on loans - internal and external for financing of the development programmes in the nation specially since 1970. The total public debt of the central govt. stood Rs. 4979 crores in 1960-61 comprising internal debt and external debt of Rs.3978 crores and Rs. 1001 crores respectively. This amount increased to Rs. 16931 crores including Rs. 11107 crores as internal debt and Rs. 5824 crores of external debt in 1973-74 which reached to amount of Rs. 325196 crores including Rs. 274568 crores and Rs.50628 crores of internal and external debt respectively. in 1994-95(R.E.).

The objective of my study is to make a comprehensive analysis of the various sources of the internal borrowing and the rate of interest guaranteed thereon. The necessary amount of internal debt produces a number of economic feffects due to transfer of the funds from the public to the govt. and later their payment of loans and amount of interest to the lenders. It is said that internal debt does not create real burden on the society due to mere transfer of funds from the private pocket to the govt. pocket and reverse at the time of repayment. Thus the real wealth of the nation remain within the country. My objective is to study and establish the fact that how far the mere transfer of funds in such a way may or may not effect production, prices and redistribution of income specially when the govt relies upon the deficit financing. It is also to be studied the technique of govt. of India to manage internal debt repayment of loans and interest payments. Finally my objective of study is to find how far the borrowed funds have been utilised for the productive and creative purposes, and the effects of utilizing the tax-revenue resources, for interest payments and subsequent effects in the society.

This work contains six chapters. In the first chapter the main aspect of economics of govt. borrowing have been highlighted as the introduction of the thesis, since the govt. of India rely largely upon the borrowing for financing the development schemes and large and small projects. The various points have been raised in the introductory chapter to study which is based upon the theory and practise of public finance. For this purpose the help of the literature of the authentic and eminent economists have been sought. It is also based on the study of Annual Union Budgets, Report on Currency and Finance of R.B.I., Economic Survey of Govt. of India, various issues of Economic intelligence service and the work of various experts on public finance on internal borrowing in India for the purpose of analysing it in India's Context.

The second chapter deals with the importance of debt financing in India. It also studies the difference between the private borrowing and the govt borrowing and the scope of public borrowing in a developing countries. The funds are raised through borrowing, the govt. use their for economic development of the economy. The preference of the govt. for borrowing internally over the external borrowing has been critically analysed in the chapter. The views points of different schools of thoughts on debt financing have also been studied.

The third chapter takes the view of the sources of internal debt, its kinds, trends and composition. This study has been made internal debt since 1970. Therefore the data has been compiled and analysed. The ratio of internal debt to G.D.P. and the percentage of market loan and advanced of the total internal public debt, the revenue and capital receipt and the summary of the annual budgets have been focused to understand the realities of the govt. borrowing internally.

Fourth chapter is meant for studying the debt management policy of govt. of India. It highlights the objective and methods of debt management so far adopted by the govt. of India, the efficiency and the short comings of the govt. in this regards. It also analysis the voluntary and compulsory loan schemes and short term and long term borrowing, maturity of loans their repayment and calculation of interest rates under the changing economic condition.

In the chapter five the economic effect and the burden of internal public debt have been studied. How the income and consumption at the time of raising the funds through borrowing from the public and at time of repayment change and this process plays role in changing the general price level in the country. The amount of interest on Internal public debt is annually paid as a trsnsfer payment in the revenue budget out of the revenue receipts mainly collected through the taxes has been analyse the effects of this process and the burden in the form of strain on the tax payers. The chapter present the relationship between population and internal public debt and the percapita amounts of both in the country, the burden in terms of amount of interest and the relationship between total tax revenue and amount of interest. It also discuss the assets and liabilities of govt. of India as a result of an act of govt. borrowing.

Lastly the chapter sixth has been devoted for the conclusion of this study and some important suggestions and recommendations have also been included in it.

C H A P T E R-II

DEBT FINANCING AND THE ROLE OF INTERNAL DEBT IN INDIA

In the Keynsian economics fiscal policy playes a significant role in correcting the imbalance in aggregate demand and aggregate supply. It is assumed to be very effective policy attaining the goal of economic growth and stability. In contrast to the Keynesian approach the classical economists who rejected the hypothesis of the unemployment occurred due to excess of agg supply over aggregate demand. It was believed that there was no possibility of appearence of the situation where agg demand could shortfall of agg-supply in any circumstances before the publication of Keynes, "The General Theory of Employment, Interest and Money 1936[1]. The period of 1930's is well known for a number of additional responsibilities and functions of the Govt. regarding the encouragement to industry, agriculture and labour on the one hand and the promotion of public welfare with extension responsibilities of control of the economy on the other. The total shape of Govt. budgeting has altogether changed since then. It was not the problem of keeping budget small and balanced but the attention shifted on boosting the

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1. Keynes, J.M. "The General Theory of Employment, interest and Money".

economy through as much direct participation of the Govt. as possible.[2] Govt. started to undertake developmental projects and building infrastructure in the economy thus public sector emerged as a giant and powerful partner. Specially in the mixed economy like India.

India since independence launched the plan development of the economy under the five year plans. It was not possible for India to manage the huge amount of financial resources required for the development purposes, specially by its own. Therefore the Govt. resorted the course of deficit financing and borrowing[3]. Moreover, India was economically backward and underdeveloped that time. National savings of private sector were megre. There was little opportunity of private financial investment during those days. The wealth was fashionably hoarded in the country. Any excess of income over consumption leading to financial resources were not meant for productive purposes. The Govt. of India started different schemes to promote savings in the country and moblise them for the productive purposes. Undoubtedly internal borrowing articulated the proper

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2. Singh, S.K., "Public Finance in Developed and Developing Countries", S. Chand & Co. (Ltd), New Delhi, 1982.

3. Sreekant Laradhya, B.S. Public Debt and Economic Development in India, Sterling Publishers (P) Ltd., New Delhi, 1972, p. 5-6

channel of the financial resources for their optimum use. It is also reflected that our financial institution specially, banking was also not developed at that time. The different steps were taken by the Govt. to make the financial resources available in the country for development and productive purposes. Though the Govt. borrowing is likely to have effects upon the economy substantially different from those of other methods of financing and existence of a large amount of debt may likewise have significant consequences. The effects of retiring the debt is also very significant. Govt. borrowing has the great impact as well as other economic organs may also have some important effects.

In recent years Govt's. expenditure is increasing faster than their ability to raise resources, because now their activities are not so limited as only to maintain law and order and protect the country against external aggression. Therefore when expenditure exceeds revenue, deficit arises in the Govt's budget. This deficit can be bridged by raising the revenue from taxation or by borrowing from the people or adopting the policy of deficit financing[5]. Both in developed and developing countries, there are certain limits beyond that taxation rates cannot be raised without having the adverse effects on the investment level and production. Deficit financing sometime

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4. Ibid, p. 10

5. Bhatia, H.L. "Public Finance Vikash Publishing House, New Delhi, 1976.

becomes necessary even unavoidable under certain conditions, but its excess in the economy may lead to inflation and other unhealthy effects.

Public borrowing has been preferred by all countries alike developed or developing for raising their financial resources. Prof. P.E. Tylor has defined public debt as, "Govt. debt arises out of borrowing by the treasury from banks, business organisations and individuals. The debt is in the form of promises by the treasury to pay the holders of these promises a principle sum and in most interest on that principl borrowing is resorted to provide funds for financing a current deficit".[6]

In other words public debt may be defined as sums owned by Govt. in the form of bonds, notes, bills etc. and requiring the payment of specified amount of money to the holders at designated times. For the most part public debt differ, from private debt only in fact that it is an obligation of Govt. rather than of private individuals or corporations. Govt. borrowing in the strict sense includes only borrowing from the private sector of the economy; from individuals, corporation and various financial institution including banks[7]. When the Govt. obtain its funds from the

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6. Tylor, P.E., Economics of Public Finance, New York, M.M.& Co.'49

7. The New Encyclopedia, Britanica Inc. V-15, (Knowledge in Depth) William Benton Publisher, 1943-1973, p. 187.

central bank it is really creating money rather than borrowing it, since the purchasing power is made by the central bank and no obligations to the public are created.

When a govt. borrows, funds are transferred from the lenders to the govt., the lender exchanging his money for govt. securities. This effect is to reduced the liquidity of the lender that is his command over cash, to an extent dependent upon the nature of securities. The reduction in liquidity is small with short term securities and greatest with non-sable or transferable and non-redeemable securities though they are very uncommon in practise[8].

Funds lent to govt. mostly come from saving in contrast to the taxes which are more likely to come out of consumption. Such funds raised by govt. through borrowing are income generating to the people and are used for the most productive purposes by govt. Such funds raised by govt.through borrowing are income generating. For the payment of taxes many individuals are forced to reduce their consumption since they have no margine of saving and either unable or unwilling to go into debt, while others do so as a matter of choice in order to keep their saving intact. Lending on the other side is entirely voluntarily, the person who buys govt.securities is not likely to increase his rate of saving in order to do so

8. Ibid, p. 187.

or to decrease his consumption. If Govt. borrowing raises the market rate of interest this may inturn encourage the diversion of additional money to saving as the Govt. securities that offer additional incentives, for example, small denomunations or redeemability which are not possess by other securities. Such effects are generally not considered significant although the net effect of Govt. borrowing on total spending and consequently on employment and national income depends upon its influence on real investment i.e. that the purchase of new capital good or any other assets. In a period of unemployment, when savings are available then investers may be prepared to use govt. borrowing does not compete with private nor makes it more costly. Under such condition the Govt. makes it efforts to absorbe funds that would otherwise be idle. The situation of full employment is very much different. In such a situation the banks provide loans to the extent to their reserves in real investment absorve all the savings. The Govt. borrowing helps to restrict private spending as much as an increase in taxation.

Govt. borrowing is of economic significance in other number of ways. First, the buying and selling of Govt. securities provides the central bank with a means of influencing money supply. Such action is considered essential for monetary policy in the modern economic society. Secondly, borrowings avoides the adverse effects of taxation on incentives specially if the taxes are raised progressively and sharply. Thirdly, borrowing permits Govt. expenditure to be higher than what it would be otherwise feasible. This type of borrowing may be uneconomic and unproductive. Lastly, the foreign borrowing of a Govt. gives her access to a greater quantity of foreign exchange which enable her to finance the import of capital goods essential for economic growth. This consideration is of great concern to the developing countries[9].

Moreover, there are two sources of public borrowing usually, internal and external. Govt. generally prefers to borrow within the country so the interest that they have to pay might not go to foreign countries and adversely effect their balance of payment position. But when the money at cheap rate is available in foreign market or when it is necessary for economic development of the country to purchase capital goods in foreign market, Govt. do borrow in foreign market. However borrowed money should be invested in such a manner so it may yield some money income in future or it may ultimately expand the productive capacity in the economy[10].

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9. Ibid, p. 188.
10. Op. cit., p. 30.

IMPORTANCE OF PUBLIC DEBT IN DEVELOPING ECONOMY :

The desirability of Govt. borrowing has been debated far centuries. The traditional argument against borrowing is ofcourse the interest burden to which it create. Such argument is applicable equally to both private and public borrowing. In case of public borrowing these interest obligations are not met with either higher levels of taxes that may have adverse effect on the economy or reducing expenditure on other heads, that may be rather more significant or useful. The payment of interest may easily result in transfer of purchasing power to higher income groups which is just contrary to accepted norms of equity[11]. As a matter of fact the financing of expenditure by borrowing tends to produce higher prices and other inflationary effects specially in the period of full employment, because they increased total spending. During the period of full employment any increase in Govt. expenditure not offset by an equalant decline in private spending for consumption or investment will be inflationary. This argument is usually given against the use of borrowing instead of taxation from the point of view of the goal of the stability. It is basically relevant to the central Govt. borrowing, because the central Govt. must assume the primary responsibility for reducing economic instability, though the borrowing in federal system at any level of course becomes inflationary.

11. Tyagi, B.P., Public Finace, Jai Prakash Nath & Co., Meerut, 1975.

It is strongly argued against the public borrowing if it is used,it can lead to increase in Govt. expenditures beyond level regarded by society as the optimum which result into reduce the pressure for efficiency and elimination of waste. Govt. undertakes some expenditure as an adverse reaction to taxation that serves as an offsets against the favourable response to more public goods that will be paid by taxation and thus facilitate the attainment of balance between social goods and private goods[12]. On the other if borrowing replaces taxation as it is generally accepted an appropriate alternative system of financing, the pendulum may swing in the direction of larger Govt. activities which will lead to loss of such appropriate balance. The history avinces that this danger face in the early 19th century in the U.S., when large sums of money were borrowed for the purpose of the narrow goals of the society. The basic trouble with borrowing is relates to the comparative degree of painlessness as long as the society disregard its future consequences.

The opponents generally say that there is always a possibility that Govt. may accumulate very large amount of

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12. Musgrave, R.A. & P.B. Margraw, Public Finance in Theory and Practise, New York, Mac-Graw-Hill Book Co.,1989,p.

debt that may cause the loss of confidence of the people and may also reach a point at which it can fail to meet its obligations. Such loss of confidence may make borrowing difficult whenever additional funds are required to meet emergency. It may further check economic development by lessening optimism on the part of businessmen. If a Govt. goes so far into debt business that it cannot meet her obligations and credit worthiness is seriously impaired. A Govt. under such condition finds herself in difficulty in taxing potentialities and control over the banking system is hardly liable to find herself in a position to meet interest obligations or selling bonds. Therefore if public debt were exceeds certain level, the Govt. might be unable to sell bonds extensively to private sector and thus be forced to resort to borrowing from the central bank that is most inflationary form of financing[13].

The above arguments are mostly believed to constitute a pertaining case against general relaince on borrowing. In its contrary there are strong advocates of public borrowing specially under the three important circumstances :

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13. Buchanan and Flowers : The Public Finances, An Introductory taxt-book, Homeward - Inc. R & I, 1960.

1. It is argued that in a period of unemployment on depression or both, the basic argument against the Govt. borrowing that it causes to generate a tendency of inflation but in this context its considered to be irrelevant. Under such situation any expansionary effects that the financing of Govt. expenditure by borrowing instead of taxation may tend to bring about an increase in output rather than an increase in general price level. According the use of borrowing money may be regarded as justifiable in terms of the goal of lessening the security of depression and attaining greater economic stability[14]. However it is said that this justification for depression borrowing as a means of recovery, because in a severe depression borrowing could only be avoided by a sharp curtailment in activities which would not only aggravate. The depression but it would be politically intolerable. Even if this point of view that Govt. cannot successed in bringing about recovery from depression by descritionary action it must still be recognise that to some extent relaince on borrowing in depression is inevitable and justified for avoiding the aggravation of depression.

An alternative to borrowing in time of depression is the creation of money through the central bank. The Govt.

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14. Op. cit., Tyler.

borrows from central bank which creats the required amount and increase the money supply. Money creation offers two significant advantages, no obligation to repay debt takes place and there is no direct depressing effect on private spending. The funds spend by Govt. are merely created rather than being taken from the society[15]. A secondary advantage is the increase in commercial bank reserves that result from the process consequently the banks are made more liquid and can expand loans. Thus it may stimulate investment. Although Govt. hesitate to use money created by central bank as a means of financing deficit in period of unemployment. The basic reason for this widespread belief that money creation is easy source of financing but it is a source of inflation. This opinion is based upon the dark memories of runaway inflation that have occurred in various countries in the past when those Govt. resorted to excessive creation of money. So long as the method of deficit financing with careful use of the technique most economists believe that the danger are very much limited[16].

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15. Dalaya, Chandra, Internal Debt of Govt. of India Bombay Vora & Co. 1966, p. 14-15.

16. Ibid, p. 16-17.

2. Second argument given in the use of borrowing holds strong when it becomes inevitable in the period of big war. If taxes were increased sufficiently to finance all war costs, they could seriously impede the war effort by impairing incentives to work and by reducing. The over-all morale of the people. The limits of economically and politically tolerable taxation may well be below the maximum feasible allocation of resource to the war effort. Adequate tax increases would also aggravate the inequities of tax structure; an overall level that would reduce total consumer spending to a level equal to the rate of output of consumer goods might well push some person below subsistence levels and make it impossible for others to meet fixed commitments. While the use of borrowing as a method of war finance makes the control of inflation more difficult, there appears to be no escape from the necessity[17].

3. When Governmental activities require capital outlays far in excess of usual expenditure and of a non-recurrent character, their borrowing is not only virtually imperative but it is entirely justified. This rule is of primary concern

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17. Bhargava, R.N., Theory and working of Union Finance in India, London : George Allen & Unwin Ltd. 1956.

to central govt. because at higher levels the rates of nonrecurrent expenditures to total expenditures is much that tax financing is possible without undue fluctuation in tax rates or hardships to tax payers in particular years. But central govt. must often make expenditures far in excess of usual annual income on projects that will last over a period of years. In such cases, the failure to use the loan method would tend to hold expenditures for such purpose below the optimum level because tax payers will fight such sharp increase in taxes, particularly if the capital outlay will tend to benefit tax payers in future years. The argument is particularly strong in the case of self-liquidating projects such as power or water system expansions and is valid even when the outlays are to be paid off out of tax revenue. It must be emphasized that the characteristic feature justifying the use of borrowing is the nonrecurrent element; the mere fact that the object of a particular expenditure will last a number of years is not in itself a justification if roughly the same amounts will be spent each year. In the developing countries the developmental project is financed through borrowing. In the whole process the govt. remains very alert and careful not to generate excessive rate of inflation due to sharp rise in prices but it has to maintain timely balanced between aggregate demand and aggrigate supply.

After the second world war the political situation rapidly changed. The whole world was divided into two major blocks namely block of Socialist and Communist and other the Capitalist countries. Socialism not only taken large number of countries in its fold but capitalist system had great threat. Therefore the capitalist countries introduced active role of the public sector in the economy. Moreover the less developed and economically backward economies face a great challenge to survive in the developing world. Most of such countries launchaged the programme for their economic development. India also undertook the task of the development[18]. From the first five years plan, the govt. laid great emphasis on agriculture, industry mining and the developing the social heads like education, health and welfare. The goal of development as we know was not possible to be achieved without strengthening heavy and basic key industry sector. This sector is basically capital intensive, therefore India required large amount of capital and technology that was mainly imported, consequently our imports were excessively greater than our exports. India had no alternative other than going for external assistance

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18. Tripathy, R.N. "Public Finance in Underdeveloped Countries, Calcutta, World Press, 1988, p. 314.

and borrowing. The external public debt has started to grow fastly. In other words our five year plans carried huge amount of investment specially for purchasing the machinary and know-how. Whatever may be the pace of progress in the country the fact is that the such ambitious planning could not be possible unless and untill the borrowing is made by the govt. for these developmental plans.

India was economically poor it managed the funds raised from internal and external borrowing to complete huge projects. Borrowing has not been only limited to the developing countries, it was also practise in the developed countries like U.K., U.S.A., Canada, Australia etc[19]. It was not considered as an unsound policy for developing countries. India made its efforts to make the borrowing either internally or externally but the funds such raised should be utilised for the best viable purpose. Ultimate goal has been made them vible. It has been our set back that we faced war against China and Pakistan and we suffered to achieve the development targets as they were set. Even govt. used borrowed funds for recovery and development. Prof. Mehta has rightly observed, "we are all fortunate

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19. Op. cit., p. 24.

as roughly 75% of our national debt are productive, through the help of R.B.I. the govt. is floating loans on sound grounds and there is nothing to worry about the total quantum of loans"[20].

Public borrowing in India has been made by the govt. in the time when income of the govt. fell short of its expenditure. This sort of budget deficit arose due to ever increasing planned and non-planned expenditure. In addition to it, India faced unforseen contingencies like floods, femines ,epidimics , etc. The centre had to share the burden fell upon the states. The revenue receipts specially from taxation were limited, there is a little scope of additional taxes or raising the rate of taxes already in practise beyond the taxable capacity. This type of steps might have an adverse effect on the incentive to work and savings. Ultimately govt. had no wayout except go into borrowings. Briefly we can say that borrowed funds have been used for the development purposes, building infrastructure, elimination of unmployment and poverty, defence and meeting the natural

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20. Mehta, J.K., Public Finance, Developing Federal Finance 6th ed. Allahabad, Kitab Mahal, 1964.

The problem of stimulating the growth of Indian economy has been the important issue since political independence. Economic planning started in 1951 with aim of promoting rapid and balanced economic development which is a very complicated process. It is difficult to consider any angle factor as the prime mover in the process of economic development. There may be a number of factors such as natural resources, spirited enterprises skilled labour force and a dedicated civil service. But capital formation or mobilisation financial resources is fundamental to the whole problem of economic development. Although its true that mere supply of capital is not a sufficient condition for economic development, but increased capital is obviously a necessary concomitant of it. An adequate supply of capital with appropriate method of mobilising the financial resources is prerequisit for economic development of a country. As Ursula K. Hicks observes, "choosing the appropriate methods of finance cannot make a bad plan good, but it can make it better. Using the wrong methods can wreck even the best of plans". Various methods can be used for

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21. Gurley, J.G., E.S. Shaw, "Financial Aspects of Economic Development". The American Economic Review, XLV (Sept. 1955), p. 515.

mobilising financial resources and their implications for the economy are much important issues in the Economics of Development[22].

The theory of "Big Push" developed by Paul N. Rosenstain-Rodan, suggests that the initial investment must be fairly big to launch a country into self sustaining growth. According to this theory, "There is minimum level of resources that must be devoted to a development programme if its to have any chance of success. launching a country into self sustaining growth, it is little like getting an airplane off the ground. There is a critical ground speed which must be passed before the craft can become airborn. Proceeding "bit by bit" will not add up in its effects to the sum total of the single bits. A minimum quantum of investment is a necessary, though not a sufficient, condition of success"[23]. Further the "critical minimum effort thesis" of Harvey Leibensten also emphasises the fact that the amount of initial investment must be

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22. Hicks, U.K. Development Finance Planning and Control (Oxford : Clarendon Press), 1965, p. 37.

23. Paul N. Rossens Rodan, "Notes on the theory of the Big Push in Reading in Economic Development, Ed. by and others (California)

sufficiently big to achieve economic progress. According to this theory, "-----in order to achieve sustained secular growth in the general case, it is necessary that the initial strimulant to development be of a certain critical minimum size[24].

Moreover, both the above theories reflect that sufficiently large investment is necessary in early stage of development to launch the economy into self sustaining growth. But in developing and underdeveloping countries. Generally there are many difficulties in putting through the "Big Push" and India has been no exception. On the one hand lack of complementary factors of production and inability to check inflationary forces inherent in huge developmental efforts and the balance of payment problems seriously limit the aggregate investment that the economy could absorb, and on the other hand there are several impediments in the way of mobilising domestic savings as well as attracting foreign capital[25]. Thus inspite of the massive developmental efforts under the last seven five years plans widespread poverty still continues to dominate the Indian economic scene. National income (GNP) has indeed recorded

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24. Harvey Lerbenstein, Economic Backwardness and Economic Growth, New York, John Wiley & Sons Inc. 1960, p. 94.

25. Op. cit., p. 11.

a rise from Rs. 42879 crores in 1970-71 to Rs. 931016 crores in 1994-95 and per capita income has risen from Rs. 792.59 Rs. 10298.85 in the same period[26]. But this by no means is an impressive record and compared to the needs of growing population and to the level of per capital income in advanced countries. India's per capita income is incredibly low. Economic progress required that a part of the increased output be devoted for capital formation. But owing to the Demonstration Effects, both at the national and international levels. The consumption expenditure goes on rising, leaving a narrow scope for saving. The marginal propensity to consume being high. The margin available for saving is low for most of the people. The existence of non-monetized sector makes mobilisation of funds difficult In a non-monetized economy where there are no incentives and opportunity to save, resource mobilisation for development is comparatively difficult and the policy adopted by state to promote development is less effective. Some of the non-bank financial intermediaries which offer higher interest rates attract and divert funds to speculative trade and unproductive pvt. expenditure, and came in the way of mobilisation of financial resources for development. Resource mobilisation for development is relatively more difficult in a country

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26. R.B.I., Report on Currency & Finance (Various issues).

where the money and capital market are not well developed[27].

Thus, internal public borrowing plays a significant role in the economic development of India, not only because it obviates the need for carrying taxation and deficit financing too far in funding financial resources for development, but also because it fosters the growth of money and capital markets and creates the institutional frame work which facilitate the effective implementation of monetary policy. Public borrowing has its own limitation, ultimately the success of borrowing programmes depends upon the capacity to save in the economy, attractiveness of yield from the govt. securities etc.

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27. Op. cit., 20-21.

Table- 2.1

Contribution of Domestic borrowing in financing the public sector plan outlays.

Rs.in Crores.

Five year plan	Total Public sector plan outlay	Total Domestic borrowing*	Net Market borrowing	% of net Market borrowing to T.D.B.	% of total Domestic borrowing to total plan outlay.
IVth plan (1969-74)	15,902	61,86	23,26[£]	37.6	38.9
Vth Plan (1974-79)	39,303	13,026	58,79	45.1	33.2
Annual Plan (1979-80)	12,601	54,87	23,71	43.2	43.6
VIth Plan (1980-85)	97,500	42,396	19,500	46.0	43.5
VIIth Plan (1985-90)	180,000	87,062	30,562	35.1	48.4
Annual Plan[@] (1990-91)	59,548	51,444	11,307	21.9	86.4
Annual Plan[@] (1991-92)	62,588	50,469	11,691	23.2	80.6
VIIIth Plan (1992-97)	4,34,100	2,22,255	-	-	51.2

Sources : Five yearplans, Annual plans, Planning Commission, Govt. of India.

Reserve Bank of India, Report on Currency & Finance (Various issues).

-* = Total domestic borrowing includes; market borrowing(net) Small saving, P.Fs. Term Loans from Financial Institutions, Miscelleneous Capital Receipts (Net), Deficit Financing, others, Long and medium term borrowing.

£ = It also includes loan from State enterprises & term loan from financial institutions (Net)

@ = Latest estimates.

Govt.largely depended upon the internal borrowing for financing the plan expenditure. 39% of the total outlays in the IV plan amounting Rs. 15962 crores was financed through the internal borrowing out of this the market borrowing contributed at the 37.6% of the total domestic borrowing Rs. 6186 crores. The total public sector plan outlay though it was very large amount Rs. 39303 crores in the Vth plan, 33.2% of it was financed creating more than double amount of debt in camparision to IVth plan. The percentage of net market borrowing also increase to 45% approximately. The picture of annual plan 1979-80 and VIth plan relied equally on the mobilising resources through borrowing that stood 43.5%. During this period the percentage of net market borrowing to the total domestic borrowing increase to 46% . But, since the VIIth plan onwards the reliance on raising the funds through market borrowing has got dismal position though the 48.9% of the total public plan expenditure met out by domestic borrowing. This source played significant in financing the subsequent annual plans 1990-91 and 1991-92 where the resources domestic borrowing comprised 86.4% and 80.4% respectively during to finance plan expenditure. More than 50% of the total plan expenditure in VIIIth plan was finance through the internal borrowing.The following table gives the detail about the total public plan outlay, total domestic borrowing, the net marketing borrowing and the total domestic borrowing, percentage of total domestic borrowing to total plan outlay and the percentage of net market borrowing to total domestic borrowing.

CHAPTER - III

INTERNAL DEBT - ITS SOURCES, KINDS, TRENDS AND COMPOSITION

Internal debt comprises loans raised by the govt. of India in open market, through the sale of securities and otherwise[1]. It also includes compensation bonds and other bonds, and 15 years Annuity certificates. These borrowing are said to be permanent in nature. Besides, it also includes borrowing of temporary nature, such as treasury bills issued by the govt. of India to the Reserve Bank, State Govts. Commercial Banks and other parties. These temporary loans also includes non-negotiable non-interest bearing securities issued to International institutions, such as I.M.F., I.B.R.D., I.D.A., I.F.A.D.B. etc.[2]

However, in addition to it, there are certain outstanding liabilities, which the govt. is liable to make repayments. Since these outstanding liabilities imposes a burden of repayment upon the govt., they are taken as debt upon the govt. They include liabilities against the deposit of : a. various small savings schemes b. public provident fund contribution, state P.F. and non-govt. fund. c. Reserve

1. Tyagi, B.P., Public Finance, Publisher, Jai Prakash Nath, Meerut, 1975.

2. Ibid, p. 427.

funds and deposits of various govt. departments.

Thus, broadly speaking, internal public debt of G.O.I. can be said to be three types viz. permanent or funded debt, temporary or floating debt, and outstanding liabilities or unfunded debt. Now we will discuss the feature of internal public borrowing of the govt. of India.

1. MARKET BORROWINGS OR MARKET LOANS : Market borrowings forms the significant part of the internal debt as the rupee loans. These loans are generally term loans and dated loans. Between 1970-71 and 1990-91 the market loan of the govt. of India have increased by nearly seventeen times, rising from Rs. 4442 crores at the end of March 1970 to Rs. 70,520 crores in 1990-91[3]. In 1970-71 the percentage of market loans to the total internal debt was 58% and since then even though there has been a substantial rise in market loans in absolute terms. There share in total internal debt of the govt. of India has declined from 58% in 1970-71, it has come down to 45.8% in 1990-91. The Budget for 1970-71 took credit for Rs. 455 crores (gross) and Rs. 162 crores (net) on account of internal market loans (Rs. 427 crores and Rs. 136 crores respectively in revised estimates. The govt.

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3. Reserve Bank of India, Report on Currency and Finance 1970-71 and 1990-91.

issued on April 11, 1970, the 5½ percent loan 2000, at par, for Rs.275 crores facility for conversion at par was offered in respect of the maturing 4 percent loan 1970. Total subscriptions amounted to Rs. 290 crores-Rs. 150 crores in cash and Rs. 140 crores in conversion. After allowing for repayment in cash of the maturing loan not tendered for conversion (Rs. 38 crores) net receipts from this phase of the borrowing programme amounted to Rs. 112 crores[4]. On October 15, 1970 the govt. floated two cash-cum-conversion loans at par for Rs. 125 crores- the 4½ percent loan 1977 and a further tranche of the 5½ percent loan 2,000 issued earlier. Facility of conversion at par was offered to the 3% first development loan 1970-75. Total subscription to two loans together amounted to Rs. 138 crores, of which, subscriptions to the 4½% loan 1977 amounted to Rs. 56 crores- Rs. 43.3 crores in cash and Rs. 12.4 in conversion; subscriptions to the 5½% loan 2000 accounted for Rs. 82 crores- Rs. 32.6 crores in cash and Rs. 49.4 crores in conversion. After allowing for repayment in cash (Rs. 53 crores) for uncovered maturing loan, net borrowing from the second phase work out to Rs. 23 crores. Thus gross receipts of the Union Govt. from the market borrowings during 1970-71 totalled Rs. 428 crores; net receipts were Rs. 135 crores, or

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4. R.B.I. Report on Currency and Finance, 1970-71.

Rs. 6 crores less than in 1969-70 (Rs. 141) crores.[5]

However, similarly in 1980-81, the net receipts from the market borrowings of the central govt. at Rs. 2603 crores; a substantial rise of Rs. 642 crores as compared with the rise of Rs. 308 crores in privious year and exceeded the budgeted amount of Rs. 2500 crores. The centre approached the market six times during the year, four times directly and twice indirectly through placements with the R.B.I. for subsequent sale to investors. The total gross amount raised during the year at Rs. 2870 crores was higher by Rs. 611 crores (or 27%) than the amount raised in the privious year. The centre issued on December 26, 1980, further tranches of two outstanding loans viz. 6% loan 1986 for Rs. 125 crores and 6.5% loan 1990 for Rs. 75 crores[6]. This was followed in March 1981, by the issue of further tranches of two outstanding loans viz. 6.25% loan 1989 for Rs. 50 crores and 6.75% loan 1994 for Rs. 50 crores. All these loans which were takenup initially by the R.B.I. to be placed on sale to investors subsequently amounted to Rs. 300 crores in 1980-81 as against Rs. 250 crores in 1979-80.

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5. Ibid.

6. Reserve Bank of India, Report on Currency and Finance, 1980-81.

During the fiscal year 1985-86, the Central Govt. entered the market eight times - twice placing an amount of Rs. 500 crores each initially in favour of the R.B.I. - and borrowed a gross amount of Rs. 5,764 crores. After providing for a repayment of Rs. 663 crores on loans maturing during the year, the net receipts from market borrowings amounted to Rs. 5,101 crores recording a substantial increase of Rs. 1001 crores or 24.4% in comparison with those of preceeding year[7].

Finally, during 1994-95, according to R.B.I. records, aggregate market borrowings of the central govt. amounted to Rs. 38,108 crores (gross) and Rs. 20,074 crores (net). The net market borrowing comprised normal market borrowings of Rs. 3,700 crores, other medium and long term borrowings of Rs. 16,507 crores and a net repayment of Rs. 223 crores of 364 day treasury bills. The budget estimates for 1995-96 placed aggregate gross market borrowings at Rs. 40,806 crores and net at Rs. 27,087 crores. As at the end of Sept. 1995, the Central govt. moblised gross amount of Rs. 22,032 crores and net Rs. 12,411 crores.

During 1994-95, the interest rates on conventional and non-conventional market borrowings ranged between 11%

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7. Reserve Bank of India, Report on Currency and Finance, 1985-86.

and 12.71% for a maturing of 3 to 10 years with a weighted average of 11.90%[8]. The experience in relation to market borrowing during 1995-96 (upto Sept. 1995) shows hardening of interest rates in the range of 13.25% and 14% for a maturity of 2 to 10 years.

2. MARKET LOANS IN COURSE OF REPAYMENT : The loans raised by the govt. are repaid when new securities are purchased as a result of repayment facility provided by the govt., they are recognised as market loans in course of repayment. Though they are very similar to the market loans, but it point out the proportion of currency which has been re-invested[9]. Such loans were estimated at Rs. 6.49 crores in 1950-51 and they increased to Rs. 45.83 crores in 1990-91 and Rs. 52.34 crores in 1993-94.

3. SPECIAL BEARER BONDS : The government of India announced on Jan. 15, 1981 the scheme of Special Bearer Bonds, 1991 for cannalising the unaccounted money for productive purposes. The Special Bearer Bonds, 1991 of the face value of Rs. 10,000 each were issued at par with a maturity period of 10 years. The holders of the bonds will be entitled to receive Rs. 12,000 for every bond on maturity. The

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8. R.B.I. Report on Currency and Finance, 1994-95.

9. Op. cit., p. 428.

10. R.B.I. Report on Currency and Finance, 1991-92.

bonds confer certain benefits to the original subscriber or the possessor while the rate of interest has been kept low. There will be immunity for the original subscriber of the bonds from being questioned about the possession of the bonds or about the source of money from which the same have been acquired. However, the holder will not be liable to any penalty or prosecution for any offence under IPC or any act, for only reason that he or she has bonds[11].

Such bonds have been issued by govt. of India several times since 1950-51. The total amount of debt as a result of such bonds was nothing at the end of 1950-51. The amount of public debt due to such bonds were Rs. 964 crores in 1985-86 and remain static up to 1989-90 again it has declined from Rs. 951 crores in 1990-91 to Rs. 1 crore in 1992-93[12].

4. COMPENSATION BONDS AND OTHER BONDS : The govt. of India has raised loans through the issue or sale of various kinds of bonds in the open market. Such loans are also of long term in nature. For instance 'capital investment bonds' were put up on tap from 28th June, 1982. These bonds carry interest at the rate of 7% and have a maturity period of 10 years.

"National Rural Development Bonds" provide investment facility to persons desirous of availing of exemption from capital gains tax on transfer sale of capital assets. These 7 years National Rural Development Bonds were floated by the

11. R.B.I. Report on Currency and Finance, 1980-81.
12. Bhatia, H.L. Public Finance, p. 442.

govt. of India from July 9, 1979 and carried an interest at the rate of 7.5% per annum. The total subscriptions to these bonds amounted to Rs. 88.11 crores up to June 30,1981. Besides, the NRDB (Second issue) with a period of three years were put on tap from 7th July 1983. These bonds also carry interest at the rate of 7.5% per annum.

The govt. of India also raised loans in the form of Compensation Bonds[13]. For instance, the govt. of India has nationalised six more Commercial banks in 1980. Therefore, R.B.I. has to pay specified amounts to these banks. For this purpose, it has announced the issue of two bonds.
1. 6% bonds, 1990 to be issued as Rs. 100.00% and redeemable at par on 15th April 1990 2. 7% bonds 2010 to be issued at Rs. 100.00% and redeemable at par on 15th April 2010.

5. TREASURY BILLS : The loan raised through the treasury bills are of temporary or short term in nature. Treasury bills are the major source of short term of funds for the govt. to bridge the gap between revenue and expenditure and they have been an attractive form of investment for banks[14]. With the increasing demand for funds for investment under plans, the govt. of India has resorted to heavy

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13. Op. cit.

14. Ibid.

borrowing through the issue of treasury bills, the major part of which is held by the R.B.I. Thus, treasury bills are issued to R.B.I., State Govts., Commercial banks and other parties. These will can be converted into cash without the holder incurring larger losses. In 1988-89 treasury bills with 182 days maturity were introduced and are gaining an importance in absolute amounts. Further a huge amount of outstanding treasury bill (91-days maturity) has been funded and issued to R.B.I. The share of treasury bills in the total internal debt of govt. of India was 33.14% in 1970-71 has increased to 41.92% in 1980 and further decreased to 5.1% only in 1990-91[15]. The share of treasury bills in total internal debt has further increased to 10.9% in 1992-93.

6. <u>SECURITIES ISSUED TO INTERNATIONAL FINANCIAL INSTITUTIONS</u> :

Special floating loans represent India's contribution towards share capital of International financial institutions. The govt. of India issue non-negotiable non-interest bearing securities to the International financial institution such as International Monetary Fund, International Bank for Reconstruction and Development, International Development Association, International Fund for Agricultural

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15. R.B.I. Report on Currency and Finance, 1991-92.

Development, African Development Bank and Asian Development Bank, in lieu of their share capital. Had these securities been not issued to these institution, the govt. of India had to pay cash in his own currency[16]. Besides, the govt. liable to pay the amount at the call of these institution. Hence, it is a short of short term debt upon the govt. of India. However, special floating loan amounted to be Rs. 689 crores in 1970, has increased to Rs. 1060 crores in 1980, and further increased to Rs. 6566.2 crores in 1990-91 Thus its share in the total internal debt of govt. of India is. 9.4%, 4.3% and 4.2% respectively. The share of above has increased to 8.4% in 1992-93[17].

7. SPECIAL SECURITIES ISSUED TO THE RESERVE BANK OF INDIA :
Besides, the govt. of India loans of temporary nature from the Reserve Bank of India and issue special securities. These securities are also non-negotiable and non-interest bearing. The govt. is liable to pay the amount at the call of the RBI. Therefore, such borrowings are short term or temporary in nature for not more than 12 months or a financial year.

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16. Op. cit.

17. R.B.I. Reporter on Currency and Finance, 1970-71, 1980-81, 1990-91.

However, the amount of debt as a result of such borrowing at Rs. 585 crores in 1980 and Rs. 4650 crores in 1985, and Rs. 1,101.4 crores in 1990-91 and finally budgeted at Rs. 1,064.4 crores in 1992-93.

8. <u>OTHER OUTSTANDING LIABILITIES OF GOVT. OF INDIA</u> :

There are certain outstanding liabilities of which the govt. is liable to make repayments. Hence these outstanding liabilities are taken as debt upon the govt.

i. <u>SMALL SIVINGS</u> : Small savings as a source of borrowing for the govt. is of special significance particularly in growth-seeking, inflation sensitive economy. It is the safest from of governmental borrowing as it tapes the genuine savings of the people and provides the govt. with the much needed capital without aggravating the inflationary situation in the economy. The greater the contribution of the small savings to the govt.'s borrowing, the better it is for the economy to maintain monetary stability. But the contribution of the small savings has always been very small even in developed countries. The greater limitation to the expansion of small savings in an underdeveloped country is the inability of people to save[19].

19.B.S., Sreekantaradhya, Public Debt and Economic Development in India, New Delhi, Sterling Publisher (P) Ltd. 1972.

The policy of the govt. of India as in other countries has all along been one of promoting small saving to augment the genuine savings of the people. In the budget speeches the successive finance ministers always emphasised the importance of small savings. The Finance Minister of India in the 1953-54 budget speech, said, "as I have more than once emphasised, we shall have to turn increasingly to the small savers for providing the finance required for development. We have endeavoured to get the states more actively interest in spreading the movement by giving them a financial interest in the proceeds from small saving"[20].

Moreover, in the 1957-58 budget while paper it was stated that, "the savings movement is not merely a mechanism for govt.'s ways and means, not merely a planned measure for the fulfilment of certain specific needs, but it seek to create the habit of thrift through self help which is of lasting value to the individual and to the nation"[21]. Again in 1960, the finance minister emphasising the importance of small saving stated in the budget speech that "the small movement is more than a routine device for mobilising savings. It has a psychological appeal in providing an opportunity for the ordinary men and women to participate in the national effort for development"[22].

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20. Indian Finance, Budget Supplement (March 4, 1953), p.3.

21. Eastern Economist, Budget Nov. (March 22, 1957).

22. Lok Sabha Debate, 1960, vol. 39.

However, to make the small savings movement popular every year new promotional measures are taken which help to improve the Organisation of small savings movement, providing greater facilities for depositing and withdrawing money and offer incentives to the people to invest in small savings scheme. The rate of interest offered on small savings and the income tax concession shown on the amount invested in the small savings scheme have gradually improved. The instrument of small savings in India are the Post Office Saving, Bank Deposits, Cumulative Time Deposit Scheme, National Defence Certificates of different years maturities, National Saving Certificates of different issues, Fixed Deposit Schemes, and Bank Deposits[23].

Inspite of the various promotional measures taken to increase the contribution of small savings, collection under the scheme has not been very encouraging. Net receipt of small savings in 1970-71 was Rs. 145 crores. It has increased to Rs. 1069 crores in 1980-81 and further amounted to Rs. 5520 crores in 1991-92[24]. Net receipts of small savings have no doubt, increased year after year. But the increase has not been in proportion to the targets of small savings fixed under the different plans. At the end of March 1970

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23. Op. cit., p.

24. R.B.I. Report on Currency and Finance, 1991-92.

outstanding small savings at Rs. 2021 crores constituted 28% of total outstanding internal debt of govt. of India. By the end of March 1980 it increased to Rs. 6856 crores and its share in the total outstanding material debt of the govt. of India was 28.19% and finally at the end of March 1990 it has increased to Rs. 50,100.2 crores and its share in the outstanding material debt of govt. of India was 32%.

ii. PROVIDENT FUND CONTRIBUTIONS : The govt. of India has certain outstanding as a result of provident fund contribution the transection under this head relate to (a) State provident fund contributions (b) Public Provident fund contributions The total outstanding which the govt. is liable to repay in 1970 on account of provident fund contribution viz state provident fund was Rs. 759 crores in absolute term and its share in total internal debt of GOI was accounted at 10.4% in 1980. It has increased to Rs. 2268 crores and its percentage share in total internal debt of GOI was accounted to 9.3%. Further the amount of state provident fund and public provident fund has combined went to Rs. 11668 crores in 1990-91 and its share in total internal debt of GOI has declined to 7.5%[25].

However, the introduction of public provident fund scheme which has the objective of attracting voluntary saving mainly from the self-employed people. The scheme came into

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25. R.B.I., Report on Currency and Finance, 1970-81, 1980-81, 1990-91.

force on July Ist, 1968 and it is operated through the State Bank of India and its subsidiaries. The minimum amount that a subscriber should contribute is fixed at Rs. 100 and the maximum is fixed at Rs. 15000. The amount can be withdrawn only after 15 years, but limited withdrawal is allowed after 5 years and loan can also be taken by subscriber. The rate of interest on the balance in the account will be determined from time to time[26].

iii. <u>OTHER ACCOUNTS</u> : This account mainly consists of Postal Insurance and life amnity fund. Borrowing under compulsary deposits and income-tax amnity deposits, special deposits of non-govt. provident funds. To introduce a measure of austerity and to promote savings, a form of compulsory borrowing was introduced by the govt. of India in 1963. According to the compulsory deposit scheme bill, 1963 except those who were exempted from the scheme, all the others were compelled to keep deposits with the govt. at the specified rates. These deposits were not repayable for a period of five years and carried interest at 4% per annum. Exemption from the scheme was given to all those (1) whose revenue liability was less than Rs. 5 per annum (2) who are liable to taxes on profession, but whose income was not yet enough

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26. Op. cit., p.

to bring them within the income-tax range (3) whose salaries income was Rs. 1500 or more per annum, but below the income tax level and save 11% or more of their income by way of contribution to provident fund, life insurance premium or ten to fifteen year cumulative time deposits and (4) who owned urban property and were already paying tax on income. There was a lot of opposition to the scheme as it was felt that it imposed heavy burden on the people. In view of public resentment, the scheme was abolished and in its place the Annuty Deposit Scheme was introduced in the 1964-65 budget.

The income-tax Annuty Deposit Scheme came into force from Oct. 1964. This scheme was originally applicable to persons in the income bracket above Rs.15000 per annum, later this exemption limit was raised to Rs. 25000. The rate of annuty deposits varied between 5% and 12.5% according to the slab of income. The deposits made under the scheme were repayable in ten equated annual instalments commencing from the complete year after the year of assessment. The scheme has later been discontinued. Under this category others unfunded debt was Rs. 172 crores in 1970, that accounted 2.73% of the total internal debt of govt. of India. In 1980 this share increased to 13.82% and further it has went to 29.3% in 1990[27].

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27. R.B.I., Report on Currency and Finance, 1970-71, 1980-81, 1990-91.

Moreover, another major subcategory of other liabilities is Reserve funds and deposits which consist of depriciation, reserve funds of railways and posts and telegraphs, deposits of local funds, civil deposits etc. The total liabilities due to this category stood Rs. 864 crores in 1970. The percentage share of this category in the total internal debt of govt. of India has been marked 12% in 1970 and accounted to 14.16% in 1980 and remained static on 14.16% in 1990.

Historically, public debt as a ratio of G.D.P. generally increased during abnormal circumstances such as war, famine, and political instability and either decline or stablised during normal conditions. In the 20th century, public debt G.D.P. ratio of European and North American countries increased (often beyond unity and even beyond two) during the first and second world war periods and declined in peace time[28]. In some of these countries notably Germany and France, a high public debt G.D.P. ratio was followed by fiscal crisis, hyper inflation, political instability and finally collaps of regimes. In some others, however, notably U.K. and U.S.A. high debt G.D.P. ratios did not result in any serious problem. As pointed out by Whittlesey and others, "During the 125 years

28. Bhattacharya, B.B. & Guha Srabaini, "Internal Public Debt of Govt. of India" Growth and Composition (E.P.W. April 14, 1990).

period extending from 1690 to the end of the Nepoleonic wars in 1815, the rise in the national debt of Great Britain was persistent and substantial yet during these years the industrial revolution was successfully nartured in Great Britain. The British national debt at the close of the Napoleonic wars was about twice the level of national income of Britain at that time, and in US debt G.D.P. ratio was about one and one-half to one at the close of world war second. Inspite of the burden of this large debt, the British economy was pre-eminent in the world's economy during the 19th century. A huge burden of debt imposed upon the economy of U.S. during and after world war second did not prevent a rapid and unusually long sustained expansion of out put in the succeeding decade and half. It would seem reasonable to conclude that the burden of a large public debt is not a decisive obstacle to economic growth"[29]. Thus one cannot therefore draw any simple lesson from history. The growth of debt in each country has to be viewed in the specific context : causes of debt financing and pattern of utilisation of public debt and expenditure.

However, if public debt GDP ratio grows in abnormal conditions and stablises during normal conditions then public debt may be regarded as a temporary disequilibrium in govt.

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29. Charles, R. Whittlesey and others, Money & Banking : Analysis and Policy, (New York, The Macmillain Comp.,1963), p. 441.

finance. The current world-wide debt upsurge is, however not a consequence of war or other abnormal conditions. Except a few countries, in most countries, it has started rising from the middle of the seventies and has acclerated during the eighties. Economists are as yet unable to agree on the causes and consequences of this peace time debt explosion[30].

The total outstanding liabilities of GOI at the end of March 1995 (R.E.) stood Rs. 541629 crores or about 57.28% of G.D.P. at market price. The debt GDP ratio remained more or less stable around 42% between 1970-71 and 1981-82. But since March 1982 it has increased steadily and over a period of eleven years it has risen by as much as 18% points. Internal liabilities account for about 90% of total liabilities of central govt. at the end of March 1994, and internal debt account for about 58% of total internal liabilities. So an analysis of internal public debt of GOI is very important to understand the dynamics of public debt in India. The table 3.1 shows that the nominal value of total liabilities of GOI has increased more than thirty times between 1970-71 and 1995-96(BE) and most of the increase is on account of internal liabilities. The share of external debt in total liabilities has actually declined from 33% in 1970-71 to 8% in 1995-96 (BE). The table 3.2

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30. Op. cit.

Table-3.1

TOTAL OUTSTANDING LIABILITIES OF GOVT. OF INDIA.

Rs. in(Crores)

Year	Internal debt	Other Outstanding Liabilities.			T.Internal Liabilities	T.External Liabilities	Total Liabilities	% of Internal debt to total liabilities	% of total Internal Liabilities to total debt.
		Small savings	P.F. & other Acc.	R.F. & Deposits					
1970-71	7663	2209	1750	1757	13379	6485	19864	38.5	67.4
1975-76	13898	3946	2060	2757	22661	7489	30150	46.1	75.2
1930-81	30864	7976	5977	3634	48451	11298	59749	51.6	81.1
1985-86	71039	21449	15409	11563	119460	18624	137613	51.6	86.8
1990-91	154004	50100	56940	22150	283194	31525	314719	48.9	90.0
1991-92	172750	55755	65745	23464	317714	36948	354662	48.7	89.6
1992-93	199100	60128	76674	23753	359655	42269	401924	49.5	89.5
1993-94	245712	67285	93070	24556	430623	47345	477968	51.4	90.1
1994-95RE	274568	79055	111092	26286	491001	50628	541629	50.6	90.7
1995-96	307369	83575	125872	27667	545483	54847	600330	51.2	90.9

Source : Reserve Bank of India, Report on Currency & Finance (Various issues).

P.F. = Provident Fund
R.F. = Reserve Fund
T. = Total

also reflects that external debt as a ratio to GDP at current market prices has also decline almost steadily from 15% in 1970-71 to 5% in 1994-95. The ratio of internal liabilities to GDP has fluctuated around 30% during seventies but has risen steeply in the eighties and further increased to about 54% in 1995. During VIIth five yearplan internal liabilities of GOI increased much faster than before. Between 1984-85 and 1989-90. The ratio of internal liabilities to GDP has risen from 41.82% to 52.54%. The nominal value of internal public debt of GOI has grown about 40 times between 1970-71 and 1995-96 B.E. It has more than doubled within short period of 6 years from 1982-83 to 1988-89. All the evidence therefore indicate a big upsurge in internal public debt during eighties. Table No. 3.3 shows that market loans and bonds eccounted for 57.96% of total internal debt in 1970-71 has increased to 74.55% in 1995-96 BE and other important constituent of internal debt; treasury bills accounted for 32.83% of total internal debt in 1970-71, has reduced to 18.65 in 1995-96 BE. Similarly the percentage of special floating loans to total internal debt has reduced from 9.20% in 1970-71 to 6.79% in 1995-96 BE.

At this stage it seems necessary to have a look upon the annually trends of revenue and capital receipts and their

Table- 3.2

Total outstanding liabilities of govt. of India since 1970, and its ratio as a percentage of GDP.

Year	Internal debt	Other Liabi-lities	T.Internal Liabilities	Ext.debt	Total Liabi-lities	Debt as % of G.D.P. Internal	External	T.Internal Liabili-ties as a % of GDP	Total Liabilities as a % of G.D.P.
1970-71	7666	5225	12890	6485	19375	17.80	15.0	29.9	44.9
1975-76	13899	8762	22661	7489	30150	17.6	9.5	28.8	38.3
1980-81	30864	17587	48451	11298	59749	22.2	8.3	35.6	44.00
1981-82	35653	2025	56083	12328	68186	22.3	7.7	35.1	42.7
1982-83	46939	24251	71190	13682	84872	26.4	7.3	40.1	47.7
1983-84	50263	29878	80141	15120	95261	24.2	7.2	38.8	45.9
1984-85	58537	38267	96804	16637	113441	25.3	7.2	41.1	49.0
1985-86	71039	48292	119331	18153	137484	27.1	6.9	45.5	52.4
1986-87	86312	59935	146247	20299	166546	29.5	6.9	49.9	56.8
1987-88	98646	73692	172358	23223	195581	29.6	7.0	51.7	58.7
1988-89	114498	89527	203995	25776	229771	29.0	6.5	51.5	58.0
1989-90	133193	106656	239489	28343	268192	29.2	6.2	52.5	58.7
1990-91	154004	129190	283033	31525	314419	28.8	5.9	52.9	58.7
1991-92	172750	144964	317714	36948	354162	28.0	6.0	51.6	57.5
1992-93	199100	160554	359655	42269	401923	28.3	6.0	51.2	56.9
1993-94	245712	184911	430623	47345	477968	31.3	6.0	54.8	59.6
1994-95	274563	216448	491001	50628	541629	29.0	5.4	53.9	57.3

Source : Reserve Bank of India, Report on Currency & Finance (Various issues)
T. = Total - Ext. = External - GDP = Gross Domestic Product(Current Market Price)

Table - 3.3

Composition of outstanding Internal Public debt of govt.of India

Year	Total Internal Public Debt.	Market loans & Bonds.	Ways & means from R.B.I. Treasury Bills	Ways & means from R.B.I. Special floating Loans
1970-71	7663	4442 (58.0)	2516 (32.8)	705 (9.2)
1975-76	13898	7127 (51.3)	5810 (41.8)	961 (6.9)
1980-81	30864	16474 (53.4)	12850 (41.6)	1540 (5.0)
1985-86	71039	41937 (59.0)	26014 (36.6)	3088 (4.4)
1990-91	154004	139407(90.5)	8031 (5.2)	6566 (4.3)
1991-92	172750	151509(87.7)	12826 (7.4)	8415 (4.9)
1992-93	199100	155042(77.9)	29390 (14.8)	14669 (7.4)
1993-94	255712	184366(75.0)	4040981(16.7)	20365 (8.0)
1994-95 (RE)	274568	206291(75.1)	47942 (17.5)	20335 (7.4)
1995-96 (BE)	307369	229174(74.6)	57328 (18.7)	20867 (6.8)

Source : Reserve Bank of India, Report on Currency & Finance (Various issues)

Economic Intelligence Service, Public Finance Related to Central Invested, June 1996 (CMIE)

RE = Revised Estimate - BE = Budget Estimate.

Figures in bracket shows percentage to total internal public debt.

respective percentages to GDP. Both trends of revenue receipt to GDP and capital receipt to GDP have not drastically changed, though there is increase in the percentages with a little fluctuation. It is obvious from the table 2.4 that there was 7.75% of revenue receipt to GDP in 1970-71 which gradually increase about 11%. On the other hand there was 4.75% of capital receipt to GDP in 1970-71, this percentage also gradually increase which stood greater than 6% of GDP. In absolute terms both of these receipts have increased many times during this period. But taking in absolute terms is not much important because the figure of our national income also increased similarly.

Total receipt on both accounts (Revenue & Capital) of Central Govt.

Table- 3.4 Rs. (in Crores)

Year	Revenue Receipt	As % of G.D.P.	Capital Receipt	As % of G.D.P.	Total Receipt	As % of G.D.P.
1970-71	3342	7.75	2047	4.75	5389	12.5
1975-76	8075	10.24	4147	5.26	12222	15.5
1980-81	12829	9.44	8771	6.46	21600	15.9
1985-86	28884	11.00	21239	8.10	50123	19.1
1989-90	54669	12.16	32090	7.14	86759	19.3
1990-91	57714	10.90	41328	7.80	99042	18.7
1991-92	69211	11.51	42018	6.99	111229	18.5
1992-93	82322	11.74	47385	6.74	129707	18.5
1993-94	88764	11.03	51218	6.37	139982	17.4

Source : Economic Intelligence Service, Basic Statistic Relating to the Indian Economy, vol. I, (All India) Aug.1993(CMIE) Economic Outlook, Post Budget Review, March, 1993.(CMIE)

The total receipt as a percentage of GDP varied between 12.5% in 1970-71 to 19.5% in 1988-89, though there is a smooth increase in this percentage with little fluctuation. The study of these trends really useful in studying the trends of internal debt exclusively.

The table No. 3.5 shows the budgetary position of the central govt. that is very important to understand revenue account and capital account and the combine account. The revenue account shows that the deficit in the account has been a high as Rs. 18561 crores in 1990-91. The deficit in capital account also been the main feature of the central budget till 1986-87 except the sulplus in 1983-84 and 1985-86. But after 1986-87 the capital account showed surplus that stood Rs. 13315 crores in 1993-94. But overall the budget ran in deficit throughout the period since 1970-71 to 1993-94. It means that being the capital account surplus, the capital receipts mostly used to meet out the deficit in revenue budget. The revenue account has not been self financing. It mostly remain dependent upon capital account. Therefore it is important to note that the capital receipt have been used to meet the current expenditure rather than creation of assets or making the development in materialistic term.

Revenue and Capital Budget of the Central Govt.
Table-3.5

Rs. (in Crores)

	Revenue Account			ACapital Acc.			Total			Total as % of GDP		
	Receipt	Exp.	D.(-)/ S.(+)	Receipt	Exp.	D.(-)/ S.(+)	Receipt	Disbursement Amount	D.(-)/ S.(+)	Rect.	Dist.	D.(-)/ S.(+)
970-71	3342	3179	163	2047	2494	-447	5389	5673 -	-284	12.5	13.1	-0.7
971-72	4028	4128	-100	2504	2923	-419	6532	7051	-519	14.1	15.2	-1.1
975-76	8075	7189	886	4147	5402	-1255	12222	12511	-369	15.5	16.0	-0.5
980-81	12829	14544	-1715	8771	9633	-862	21600	24177	-2577	15.9	17.8	-1.9
985-86	2888	34772	-5888	21239	20666	573	50123	55438	-5315	19.1	20.2	-2.0
990-91	57714	76275	-18561	41328	34113	7215	99042	110388	-11346	18.7	20.8	-2.1
991-92	69211	85472	-17081	42018	32612	10049	111229	118284	-7032	18.5	19.5	-1.1
992-93	82322	99022	-13882	47385	37887	8493	129707	136901	-5389	18.5	19.3	-0.8
993-94	88764	106393	-17629	51218	37903	13315	139982	144296	-4314	17.4	18.0	-0.5

Source : Economic Intelligence Service, Basic Statustic Relating to Indian Economy, vol. I, Aug. 1993. (CMIE)

A review of central budget 1993-94.

Reserve Bank of India, Report of currency & finance (Various issue)

C H A P T E R - IV

DEBT MANAGEMENT :

The management of public debt is a set of operations which the treasury performs in maintaining a national debt[1]. The objective of the debt management refers to the aim that the method of borrowing funds and the repayment of loans by the govt. should not have any adverse effect upon the economic situation of the country. Moreover, the level of outstanding public debt and the cost aspect of internal borrowing do not pose any serious problem in the developing economy like India, but the question of maintaining the debt is important, because debt management has manifold effects on the economy[2].

Debt management involves control by the fiscal and monetary authorities, of the size and composition of debt (volume of different types of debt), distribution of ownership of debt between the banks, non-bank institutions and individuals, maturity pattern of the debt and the level and structure of interest rates and the mode of retirement of debt. As C.C.Abbott puts it, "by management of the debt is meant the choice of debt forms and the proportionate amounts of the different types

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1. Singh, S.K., Public Finance in Developed and Developing Countries, S.Chand & Co. Ltd, New Delhi, 1982.

2. Shreekantaradhya, B.S., Public debt & Economic Development in India, Sterling Publishers (P) Ltd., New Delhi, 1972.

used, the selection of pattern of debt maturities, the amount of debt placed with different classes of holders, the decision to repay or refund maturing obligations, the refunding terms offered, the treatment given to different classes of debt and different types of bond holders, determination of provisions attached to new bond issues, adaption of new issues to the needs of prospective holders, policies pursued in the retirement of creation of new debt and the relative weights given to all these matters in the govt's general fiscal policy[3]." This issue is very important because management of public debt may directly influence every aspect of our economic life during the next decade at least, and probably throughout the life of all men now living. Inept or unskillful management could be disastrous. The way in which the debt is managed, and the success achieved, will directly affect social security federal grant in-aid, banking legislation, the conversion programme and many other matters of public policy that the country has been accustomed to determine with little reference to their effects upon govt. finance[4].

OBJECTIVE AND METHOD OF DEBT MANAGEMENT : in underdeveloped economies debt management has obvious limitations. Where it

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3. Abbott, C.C., Management of the Federal Debt (New York : Mc Graw-Hill Company, 1946), pp. 2-3.

4. Ibid, p. 3.

it has come to be recognised as an independent instrument of economic policy in advanced economies where money and capital markets are fully developed and the banking sector plays a predominant role in the govt's. borrowing programme, debt management has regarded as an important instrument of economic policy. But in the underdeveloped economies the picture is not bright especially because of week financial institution and lack of efficient money market. In the case of India, where money market and capital market are fairly well developed and where banking system has a big role to play in the govt. borrowing operations, debt management policy does play an important role though not to the same extent as in case of advanced economies. Debt management may some supportive to the objective of fiscal and monetary policy. Debt management must be properly integrated with fiscal and monetary policy instead of giving it a low or high priority among the instruments of economic policy[5]. As the Radcliffe report observes, "----- debt management can be regarded neither as something to be, as it were, left to the last and adjusted to all other policy decisions nor, on the other hand, as a consideration which should override all other policy decisions; it has to be integrated with a variety of measures in the pursuit of

5. Op. cit., p. 101.

broad aims of economic policy".[6]

There are two important objectives of debt management in the context of planned development of Indian economy. One of them is to promote saving and provide large funds for investment in the public sector without impinging on the private sector and another is to ensure needful large borrowing and debt retirement without frustrating the objective of maintaining price stability in the economy. However the first objective of debt management depends upon the debt policy capable of tapping the funds from all possible sources, in the economy. A variety of debt instrument should be employed to suit the requirements of different types of investors. The debt policy should be comprehensive and flexible in offering the terms such as the interest rates and maturities suitable to the condition prevailing in the money market and the capital market. In this process of drawing funds to the public sector, it is necessary to see that private sector is not adversely affected. This requires special care in a mixed economic order where the private sector has been assigned an important role in building the national economy. The second and perhaps the most important objective of debt management may be in the coordination of the goal of economic development with stability. The loan operations should support and not disturb the objective of maintaining price stability in the economy. Debt policy should have the aim of minimising the risk of inflation.

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6. Committee on the Working of the Monetary System Report (London, H.M.S.O. 1959), p. 191.

However, the fundamental objective of India's economic policy, as in the case of most of the developing economies is to attain growth with price stability, which means the purchasing power of the rupee should remain reasonably stable. In other words high growth with financial stability.

ECONOMIC GROWTH WITH PRICE STABILITY : Some economists say that inflation is the by-product of development and other says that inflation is inevitable in the process of economic development and growth. In the process of development, money income rises more rapidly than real income (production) and therefore a rise in the price level is bound to take place. Such rise in pirces motivates the entrepreneurs but a very high and persistent rise in prices defeats the very purpose of developments. As Prof. Lewis observes, "the worst consequences of inflation occur when prices have risen so much or so long that people lose confidence in money. This does not happen in short mild inflation. People do not panic if prices rise 5% per annum for two or three years, because they believe that prices will soon fall again"[7].

Inflation has obviously many adverse effects on the developing economy. In the first place, inflation redistributes income in favour of the rich and widens the gulf between

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7. Lewis, W.A., Theory of Economic Growth (London, George Allen & Unwin, 1969), p. 224.

the rich and poor. The fixed income group will be hit hard. Among the investors, the middle class investors who select fixed interest bearing securities, insurance and saving accounts will ba affected more than the rich investors who choose to invest in equities. Secondly, inflation discourages saving and affects capital formation. It encourages speculative activities and wrong kind of investment and comes in the way of mobilising financial resources for development. It might even lead to flight of capital. Thirdly continuous rise in prices reduces the standard of living of the workers and adversely affects the efficiency and productivity of labourers and slow down the rate of growth of economy. Further, inflow of foreign capital is discouraged when the value of the currency is falling. Finally, rising price leads to stagnation or even deterioration in the export trade of the country and leads to exchange instability. Thus preventing inflation from getting out of control is very essential because monetary stability is absolutely necessary to develop saving habit and to promote capital formation, to win the confidence of foreign capital and to encourage a rapid increase in productivity[8].

Fiscal policy, monetary policy and direct controls play a significant role in controlling inflation. These measures may

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8. Maurice Frere, Economic Growth and Monetary Stability (Washington; The Per Jacobson Foundation 1964), pp. 14-15.

be effective and be supplemented by debt management. Therefore the major goal of debt management is said to growth oriented for restricting the increase in money supply in the economy with a view to controlling inflation and preventing it from creating havoc in the country. The govt. borrowing programme would draw the purchasing power from the hands of public introducing the attractive schemes for saving. First the govt. would give incentives to save and then it provide the opportunities for investment. But such borrowing however, in addition to drawing away the excess purchasing power, growth oriented debt policy should have the aim of reducing the govt. borrowing that would lead to deficit financing, and fund much of the funds for contribution to govt. loans from the genuine saving of the people. Control of inflation through debt management can be achieved by increasing the volume of saving bonds and by retiring the govt. securities held by the banking system and in this regard there are certain limitations in under developed economies. However, promoting development within the frame work of monetary stability can undisputedly be an important objective of growth oriented debt management. In this respect debt management is hardly different from fiscal policy and monetary policy. In fact, the objective of debt management, fiscal policy and monetary policy are so linked that it is difficult to make any sharp distinction between them.[9]

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9. Abbott, op. cit., p. 40.

"Actually debt management policy is but a part, albeit a most important part of fiscal policy. Debt management can act as a stablising, a regulatory or a stimulating mechanism in the economy only within this larger framework"[10]. The objective of monetary policy of regulating the cost and availability of money can be achieved through the debt management techniques. Open market operation, which is one of the techniques of monetary control is indeed an important tool of debt management. Debt policy can be usefully employed to supplement the monetary policy in regulating the cost and volume of money in the economy. It is rightly observed, "if debt management is to be useful as a technique for promoting a relatively stable rate of economic growth, it must be properly integrated with the credit and monetary policies"[11].

Thus the debt management is guided in general by the following three principles : The first principle suggests that debt should be managed in such a manner that necessary funds are available from the lending market. Besides, it is also needed that these funds are procured at the minimum interest cost. Interest payment is made out of the govt. budget which requires additional taxation. The income generating capacity of transfer payment in the form of interest is lower and so

10. Op. cit., p. 138.

11. Melvin, D. Brockie,"Debt Management and Economic Stablisation". Quarterly Journal of Economics, LXIX (Nov. 1954), p. 623.

the rate of growth will be affected[12]. Thus the first objective of debt management requires an arsenal of debt instruments capable of tapping loanable funds where they are. It also requires freedom to manoeuvre within debts limits and freedom to offer the terms (including maturities and interest rates) which the market demands[13].

An efficient debt management policy not only keeps the interest rates on govt. bonds low but such devices so that the pattern of interest rates on govt. obligations which confirm to the preference pattern of the individuals. Swapping operation is the technique used to fulfil this very objective. It consists in the simultaneous sale and purchase of govt. obligations of different maturities without changing the total volume of debt. This will satisfy the particular needs of various classes of investors. Another advantage is to prevent the debt from becoming overly concentrated in ownership. By following this policy treasury may secure more favourable interest terms.

Second principle of debt management aimed at stable economic growth requires extreme flexibility in policy. In a

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12. Op. cit., p. 293.

13. Taylor, P.E., Economics of Public Finance, Oxford and IBH Publishing Co., New Delhi, 1965, p. 203.

period of depression when wide-spread unemployment prevails, govt. should borrow from the market in a way as to have minimum contractionary effect on private demand for goods and services. Funds should not be withdrawn from those people whose propensity to consume is high at the lower economic class of the society. The best source would be to borrow from the banking system. In a situation of inflation, the reverse is true. New funds should not be created in the banking system but should be taken from potential spenders[14].

Price stability is, however, to be maintained, An absence of such stability causes the change in the value of govt. bonds. The fixed-rupee interest and fixed rupee capital value of such bonds would not be an attractive form of saving and it will be difficult for the govt. to borrow on these instruments. The third principle of debt management is to restrict borrowing operations. In order to minimise the frequency to enter the market when it is inconvenient to borrow, the best course is to lengthen the public maturities. The British consols are the best from this point of view. (A consol is an obligation of the govt. to pay a certain interest annually without any maturity debt). In such a case the treasury would retire or refund them at a time of its own choosing.

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14. The Redcliff Committee Report.

Though these principle are not conflicting even then they are to be used separately under a certain conditions. "The rub comes when conflict among them appears. A little reflaction will turnup many situations in which it is impossible to serve all the stated principles or objectives of debt management at the same time. Cheap borrowing means issuance of short term securities more often than not cheap borrowing on short term will usually contravene stablization objectives when a boom is in progress. Short term borrowing, while serving stablization goals when the problem is one of underemployment, commits the treasury to early replacement of this debt, quite possible at a time when it is inconvenient to do so. A large debt not only forces the treasury into markets frequently; it makes the treasury's actions a significant force in establishing conditions in the markets. Thus a large debt makes appropriate debt management policies both more necessary and more difficult[15].

Moreover, the monetary impact of public debt depends upon how the ownership pattern and maturity pattern of govt. debt are distributed. Ratio of bank held debt to total debt the ratio of treasury bills to total public debt, the ratio of short term debt to total debt and the ratio of supply of

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15. Tylor, op. cit., pp. 204-205.

money to total public debt may be taken as some of the indicators of monetary impact of public debt.

The inflationary or deflationary effect of public debt depends on ownership pattern that is whether the govt. securities are used for credit expansion leading to an increase in the supply of money in the economy. It is generally believed that if the govt. borrows from the genuine current stream of savings of the people or from the income that otherwise would have been spent, there will be no expansionary effect on money supply and that such borrowing is deflationary as it draws away the extra purchasing power from the hands of public[16]. On the other hand, if the govt. borrows from the accumulated idle balances held by individuals or institutions, idle money will be activated and income stream in the economy will increase leading to inflation. On the whole govt. borrowing from non-bank institutions and individuals out of their current and genuine savings may be said to be moderately inflationary and since the aim of debt management should be to minimise the inflationary pressure and not to avoid it completely, such borrowing may be taken to be competable with the objective of monetary stability.

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16. Op. cit., p.

MONETISATION OF PUBLIC DEBT :

The banking sector is perhaps the most important source of borrowing for the govt. Govt. borrowing from the banking sector is popularly known as monetisation of public debt which leads to an increase in the supply of money and influences the level of economic activity and the level of prices. Credit monetisation is as important as the currency monetisation in its impact on money supply. The quantity theory of money explains that the increase in money supply relatively to goods is the outcome of manufacture of additional money through borrowing from banks. The govt. securities held by the banks may be used for credit expansion and the people may get additional purchasing power in the shape of demand deposits leading to the creation of new money in the economy. In the words of H.G. Moulton, "the govt. borrows from the banks by selling its securities to them and the banks write up deposits credit for govt. use. The process inflates the banking system on both the asset and deposit side of their books. It blows up the system far beyond its natural size ------- inflation of the banking system inflates the money supply. The influence of the vast increase in money supply permeates the whole economic structure and effects all our economic life".[17] Govt.borrowing through treasury bills which are short term papers forimg the

17. Moulton, H.G., Can Inflation Be Controlled ? (London, George Allen & Unwin Ltd., 1960), p. 20.

effective credit base, the capacity of commercial banks to lend increases and consequently the circulation of money in the economy increases.

The inflationary impact of bank credit to the govt.also depends on how the banks get their funds to lend to the govt. and how the future operations of the banks are influenced by lending to the govt. If the banks lend out their old deposits or out of maturing govt. securities or private loans, old assets are replaced by new assets and this process would be non-inflationary since there is no net addition to the aggregate assets. But, if the banks lend out of the new deposits created by the additional income of the depositors, the process is inflationary because such lending constitutes an addition to bank lending without reducing the existing volume of loans. As B.K. Madan observes, "primarily, the process of borrowing from the banks of proceeds of additional cash acquisitions as part of general inflationary movement further the inflationary movement by transforming the surplus cash of the banking system, itself supplied through past inflation, into monetary circulation in the hands of the public"[18].

Moreover, holding of govt. securities by the commercial and cooperative banks amounted to deficit financing at least to the extent the securities held by these banks are used for

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18. Madan, B.K., "Monetary Trends and Polices in India in the Post-War Period" in Aspects of Economic Development and Policy (Bombay, Allied Publishers 1964), p. 18.

credit expansion. The overall deficit is defined as the sum of govt. borrowing from the central bank and decline in govt.cash balance, does not reveal the full impact of deficit financing on money supply. The Reserve Bank economists also hold the view that govt. borrowing from commercial and cooperative banks should also be included under deficit financing in order to understand the full impact on money supply. As pointed out by Reserve Bank, "in India the govt. budget presents deficit financing as comprising the changes in the govt. sectors cash balanced and Reserve Bank's holdings of adhoc as well as loans and advances to the govt. sector. If, however, deficit financing is defined as representing the total impact on money supply, it should include variations in (a) the holdings of govt. securities of Reserve Bank and the holding of treasury bills and govt. securities of banks (commercial and cooperation banks), (b) the foreign exchange assets of Reserve Bank as a result of the govt. sector's net purchases or sales from or to the Reserve Bank, (c) the net non-monetary liabilities of banking system as a fesult of its transection with the govt. sector, and (d) the currency liability of the govt. to the public"[19]. It is, therefore, clear that changes in the govt. security holdings of commercial and cooperative banks should be taken into consideration, while analysing the effects of deficit financing on money

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19. "Analysis of Money Supply in India", Reserve Bank of India, Bulletin, XV, July, 1961), p. 1053.

supply. If the aim of debt management is to control inflationary forces, bank held public debt should be retired by selling bank ineligible bonds to non-bank investors. The possibility of doing this depends on the conditions in the capital market and the profitability of investment in govt. securities.

In brief, we can say that debt management is a choice of policies affecting the composition and nature of existing govt. debt. Important factors are the interest rate level, the maturity schedule and the choice of lenders. Debt management includes both the issuing of new securities and the refunding or converting of existing issues. The goal of debt management policies not all of which can be fulfiled together, include minimisation of interest cost, stablization of business cycle, accumodation of particular investor class and minimisation of the debt management problem itself by extending the maturity of debt. Debt management can be a powerful economic tool because the sale of govt. securities of various maturities and at various times in the business cycle affects the capital market, interest rates and the availability of funds to private investors.

As it has been stated above that debt management includes new borrowings and the conversion or refuding of existing debt, first of all it is better to go into the policies regarding new borrowings : Govts. face a number of alternatives when undertaking new borrowing. Developed countries seldom consider borrowing from foreign sources, since they are able to obtain desired funds within the country. In case of developing countries this issue is important because they have limited potential to rise funds as domestic savings are small and not easy mobilise through financial institution. Foreign borrowing also offers the important advantage of access to additional foreign exchange which is very crucial for economic development. But foreign borrowings have their own disadvantages. The development of international lending agencies such as I.B.R.D. etc. has increased the availability of foreign loans to developing countries without the danger of foreign interference.

The govt. must strike a balance between low interest costs and attainment of the goals of economic stability. The precise policies that must be followed in the light of this objective will depend on the relative importance attached to the interest and economic stability goals, the relative effectiveness of monetary policy and other methods of attaining economic stability, and the state of business conditions.

VOLUNTARY VS. COMPULSORY LOANS : During world-war second a number of countries have adopted the method of compulsory loans such as Canada, Great Britain, etc. but U.S. relied on the voluntary approach. The compulsory system is undoubtedly more anti-inflationary, since a greater amount of money will come from persons who would otherwise spend it in consumption. But it is much less politically acceptable. But the compulsory lending has several plus points over tax increases, because in the case of compulsory lending sums will eventually be paid back, political opposition to the programme and the possible adverse effects on incentives will be less than they would be with tax increases. Compulsory lending must be distinguished from a true compulsory saving programme. The former method requires a person to place his certain amount of money, related to his income, in govt. bonds each year. The latter method requires person to save, reduce this consumption, a certain amount during the year and place it in govt. bonds, so this is more anti-inflationary method. In an emergency situation, the govt. may appeal to the people to buy bonds on patriotic grounds but it would be difficult to maintain the "crisis" like situation indefinitely.

The central govt. may influence the purchasers of bonds such as central bank, commercial banks and individuals. The choice of lender depends upon the state of economic activity. In a period of depression the goal is to obtain funds with least possible contracting effect on individual and business spending, and on the other hand in the period of full employment and inflation funds should be so created to ristrict the private spending.

SHORT TERM VS. LONG TERM BORROWING : The central govt.has much greater choice between two methods of borrowing. Traditionally, short term borrowing has been regarded as indicative of financial irresponsibility. In the beginning of 1930's many national govts. have started to invest their funds in short term securities due to easily availability of funds, lower interest rate and greater liquidity and higher security in these items. From the stability point of view, the primary disadvantage of the short term loan is the greater degree of liquidity to the investor. In inflationary period, borrowing of this sort is less effective than long term borrowing in reducing liquidity. Short term borrowing also creates a continuous problem of refunding the issues as they mature, increases the danger that large amounts of debt may come due in a period of financial stringency and embarrass the govt. Short term borrowing is harmful particularly if interest rates are expected to rise in the near future. However when inflation continues for a period of time, people become reluctant to buy any type of fixed-money-return security. It has been suggested that in such a period bonds might be sold with fixed purchasing power. But such a policy may creats problem for central govt. because there will be a mass shifting from existing securities to new ones and consequently bond market may be disorganised.

However, the difference between short term and long term arises only when there is an expectation regarding the change in rate of interest. If it is not so, there is no question of short and long term rates. For instance, if there is expectation that the rates are going to increase. As a result lenders hesitate to committ for long period as they expect to get more favourable terms later on. This demand for debts shifts from long to short market. Borrowers on the other hand, are eager to borrow before cost rise. Thus supply of debt shift from short to long market. As a result, demand for debt rises relative to supply on short end. The price of short-term debt rises and yields decline. At the same time demand for debt fall to the supply at the long end. Consequently the supply of long term debts falls and yields rises. The yield curve comes to slop upward. The reverse is happen in opposit case.

Debt management also involves adjustment of the existing debt; replacement of short term securities by long term securities, refunding of maturing issues, transfer of securities from one type of investor to another, conversion of issues and the like. Regarding maturity structure, the central govt. may change the relative size of the short term and long term elements in the debt. Short and intermediate-term issues which are constantly maturing in large volume can be replaced by long term bonds or vise-versa either they mature or through purchase or call. Replacement of short term by long term issues, advocated by many economists as it has several advantages in period of inflationary tendencies. First, it reduces the over-all liquidity of debt structure, making it more difficult for investors to use wealth in govt. securities for spending on consumption or business expansion. Second increased used of long term securities lessens the nuisance and cost of constant refunding operations and makes less frequent the danger that extensive refunding may concide with a stringency in money market, thus necessiating central bank action to support the govt's. borrowing. This action may directly opposite to the interest of economic stability. Further lengthening the maturity structure of public debt also tends to raise long term rates relative to those on short term loans.

The primary disadvantage of increased reliance on long-term securities is the higher interest rates that must be paid especially if the change occurs in period of high rates. Thus reduced competitives position of long term govt. bonds compared with other securities. The rapid fluctuations in govt. bonds, as monetary policy was used more intensively, made them less attractive investment, while private securities became more attractive while business activity remained at a high level. In terms of cost consideration alone, the appropriate time for a shift toward long-term issues is in depression, while short term funds become very cheap in such periods, it is more profitable for the govt. to take advantage of low figures on long term issues. On the other hand, short term borrowing keeps the lender's investment highly liquid and facilitates their spending the sums for consumption or business expansion whenever they wish. Thus cost and stability considerations suggest opposite policies. The former requires shofting from short term to long term loans in depressions, while the latter dictates this shift in periods of inflation. But the liquidity considerations are probably not very important in depression periods, nor is the gain from the shift toward long term securities in inflationary periods. The important consideration is that the overall length of issues be relatively long when inflation does arise.

For many years, govt. has been following a policy under which the govt. undertook borrowing at rates of interest which were way below market rates and as this resulted in a large monetisation, high reserve ratios were prescribed; this, in turn, created distortions in the banking system with unusually high lending rates on certain segments combined with relatively low interest rates on deposits. In other words, the economy paid the price of keeping down the cost of govt. borrowing. But, even here, there were limitations upto which the govt. could transfer the burden to the banking system and in a futile attempt to keep down the nominal rates of interest the govt. offered large fiscal concessions. In the event, the govt. paid a far higher price than what would be necessary had it moved over to a market related system of borrowing[20].

The govt. securities interest rate for 30 year paper was as low as 6.5 per cent in 1977-78. It is of interest to note that at that point of time it was felt that changes in coupon rates on long dated securities of more than say one-fourth of one percentage point would destabilise the securities market ? Nonetheless, the rate was moved up in somewhat hesitant steps to 8.0 per cent in the late 1970s. In 1981, an internal group in the Reserve Bank advocated an activation of internal debt management policy and recommended a none-shot three percentage point increase in the govt. securities coupon rate. While this recommendation was only partially implemented by somewhat smaller district increases in interest rates, bringing the rate for 30 years to 10.5 per cent, it was left to the Committee to Review the Working of the Monetary System (Chairman : Professor Sukhamoy Chakravarty),

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20. Tarapore, S.S.- The Role of an active debt management policy in the Economic Reform Process RBI Bulletin, (Sept. 1994),

to recommend a structure of interest rates which would be market related. The Chakravarty Committee recommended that the long-term securities rate for 15 years should be three percentage points above the anticipated long-term inflation rate. In 1985, the maximum coupon rate was raised to 11.5 per cent while the maximum maturity was reduced to 20 years and in 1986, auctions for 182-Day Treasury Bills were introduced. Then, followed a. period when the maximum coupon rate was left unchanged but the range of rates was telescoped.

In 1992-93, there were a number of policy changes to activate internal debt management operations and it was recognised that pre-emption of resources of the banking system would need to be reduced to ensure more efficient resource use. The monetary policy of April 1992 heralded a new approach to internal debt management by introducing market-orientation in regard to absorption of govt. of India rupee dated securities and longer-term Treasury bills. An auction system was introduced for Central Govt. securities including securities including treasury bills of varying maturities. This was to be facilitated by the overall reduction in the government's borrowing programme in 1992-93.

One of the main features of the reoriented internal debt management policy was to make government dated securities attractive to investors. Secondly, interest rates were allowed within an overall ceiling to respond to the market. In 1991-92, the maximum coupon rate was raised in two steps from 11.5 per cent to 12.5 per cent, while the maximum maturity was reduced from 20 years to 15 years. In 1992-93, the maximum coupon rate was at 13.0 per cent for 15 years. The Central Government securities were auctioned for shorter maturities up to 10 years at at cut-off yields/ coupon rates ranging from 12.0 per cent for a 5 year to 12.75 per cent for a 10 year maturity. In 1993-94, the maximum coupon rate was raised to 13.5 per cent with a further reduction of maximum maturity to 10 years[21].

However a major lacuna in the functioning of monetary policy is the automatic monetisation of the budget deficit. In fact, in a well functioning system, the extent of monetisation should not be determined outside the framework of the monetary policy. In fact, internal debt management policy should accept monetary policy as given and the skill of internal debt management policy should be to minimise the cost of borrowing under a given monetary policy which would indepedently determine the extent of monetisation. It is important to ensure that debt management policy should be oriented to financing the government's requirements from the open market thereby enabling the Central Bank to use open market operations for regulating monetary growth. Further internal

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21. Internal Debt Management Operations, R.B.I. Bulletin (Sept. 1993) (Supplement).

debt management policy needs to develop greater degrees of freedom by lengthening and shortening the maturity and raising and lowering interest rates. As the instrument of internal debt management policy is activated, it is essential that there has to be close co-ordination with monetary policy and the delineation of responsibilities are also clearly defined. The Reserve Bank of India has set up with effect from October 1, 1992, a separate Internal Debt Management Cell to focus exclusively on internal debt management policy and operations. The Cell is expected to evolve an active debt management policy and by evolving new policy instruments and techniques it is hoped that it would facilitate the emergence of an active and efficient Government securities market.[22]

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22. Tarapore, S.S. -"Towards An Active Internal Debt Management Policy" - Reserve Bank of India Bulletin, Oct.1992.

CHAPTER - V

ECONOMIC EFFECTS AND BURDEN OF INTERNAL PUBLIC DEBT

Govt. borrowing is likely to have effects upon the economy substantially different from those of other methods of financing, and the existence of a sizable debt may likewise have important consequences. The effects of retiring the debt may also be significant. National govt. borrowing has the greatest impact, but that of subordinate units may have some influence as a well.Govt. borrowing in the strict sense includes only borrowing from the private sector of the economy - from individuals, corporations and various financial institutions including banks.When the govt. obtains it funds from central bank it is really creating money rather than borrowing it, since the purchasing power is made by the central bank and no obligations to the public are created[1].

Public debt produces effects in two ways which effect the economy of a country. When a govt. borrows, funds are transferred from the lender to the govt., the lender exchanging his money for govt. securities. The effect is to reduce the liqiudity of the lender-his command over cash - to an extent depend upon nature of securities. The reduction in liquidity is small with short term securities and greatest with non-salable, non-redeemable securities. Funds loaned to the govt.almost

1. The New Encyclopedia, Britannica, v-15 (Knowledge in Depth), William Benton Publishers, 1943-1973.

certainly come from savings, unlike for example, funds paid in higher taxes which are more likely to come out of consumption. To pay higher taxes many individuals are forced to reduce their consumption since they have no margin of savings and are unable and unwilling to go into debt; others do so as a matter of choice, in an effort to keep their saving intact . Lending on the other hand is entirely voluntary. The person who buys govt. securities is not likely to increase his rate of saving in order to do so or reduce his consumption. If govt. borrowing raises the market rate of interest, this may in tern encourage diversion of additional money to saving as may govt. securities that offer additional attractions[2].

The second effect of public debt is remote and refers to the benefits that the expenditure of the borrowed money confers on the people. If the revenue is used for the same purpose for which borrowed money is utilised both will confer the same benefit. But this happens rarely, generally, borrowed money is used to finance different types of public expenditure according to rule of public finance, current govt. expenditure should be tax financed while capital expenditure should be financed by loan. This difference is not in many cases radical J.K. Mehta , for instance, observes, "tax-revenue is used to pay teachers salaries while loan money may be utilised to

2. Singh, S.K., Public Finance in Developed and Developing Countries, New Delhi, S. Chand & Co. Ltd., 1982.

construct school building. The effects of both these expenditures are the same. They both improve the intellectual and perhaps also the physical and moral health of the people".[3] But there are cases when the difference is clearly marked. We may cite the case of loan financed expenditure on war construction of irrigation dams, power generation plans and factories producing steel. The effects of such expenditure are different from those of current govt. expenditures. The course of the difference is the future benefits that loan-finance expenditures render to the people. However, the effect of public debt depend on many considerations, such as the sources of borrowed money, purposes of borrowing, terms and conditions of loans, the volume of existing debt, general conditions of the economy and so on.[4]. In other words we can say that the net effect of govt. borrowing on total spending and thus on employment and national income will depend upon its influence on real investment - the purchase of new capital goods. In a period of unemployment, when savings will be available in greater quantity than investers will be prepared to use, govt. borrowing will not compete with private investment nor make it more costly. In effect, the govt. will be obsorbing funds that would otherwise be idle. In period of full employment the situation is substantially different.

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3. Mehta, J.K. Public Finance, Developing Federal Finance, 6th ed. Allahabad, Kitab Mahal, 1972.

4. Op. cit., p. 279.

Further, effects of internal loans should be considered separately from those of external loans[5].

The sources of loan has an important bearing on the economy as a whole=borrowing from individual or institutions does not create expansionary effect so long as idle savings are not activised. Borrowing from central and commercial banks is expansionary because additional purchasing power is created as a result of credit creation. Financing the wasteful expenditure does not lead to increase in social welfare. Size and terms of loans have an important bearing on the economy. As Buchler States, "The larger the loan is, the more palable will its effects on the economic system tend to be. If the govt. employ borrowed funds more productively than private enterprise would, the social income is increased, in case of unproductive use, the social income suffers"[6]. Further long term loans at lower rates of interest are more beneficial for the society. But a programme of public borrowing that causes apprihension about the financial stability of the govt. is harmful and may create contractionary effect on the economy.

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5. Op. cit., p. 188.

6. Buchler, A.G., Public Finance, 1948, pp. 707-708.

Moreover, govt. borrowing is of economic significance in several other respects. First, the buying and selling of govt. securities provides the central bank with a means of influencing the money supply, essential for effective monetary policy second, borrowing avoids the adverse effects that taxes may have on incentives, particularly of the taxes are raised sharply above levels to which personshave become accustomed. Third, borrowing permits govt. expenditures to be higher than would otherwise be feasible. Finally, external borrowing of some govts. gives them access to a greater quantity of foreign exchange[7]. In order to know the full effects of public debt, we have to specify the influence of public debt on various aspects of the economy.

<u>EFFECTS ON CONSUMPTION</u> : In general issue of bonds by the govt. raises the rate of interest. If saving is interest elastic this will raise the level of saving and consumption will, therefore, decline. An individual who holds the govt. bonds regard them as a portion of their personal wealth and accordingly consider themselves to be wealthier than they would if they had only tax receipts. This may make them spend more on consumption and save less. The additional consumption may reduce the rate of capital formation and economic growth. "--------funds that otherwise would have gone into consumption are diverted into purchase of govt. bonds. To the extent this

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7. Tripathy, R.N., Federal Finance in Development Economy, Calcutta, The World Press, Ltd, 1960.

occurs, the initial results of loan finance are similar to those of finance by consumption taxes"[8]. On the other hand if saving is not interest elastic, the holding of additional bonds increases people's net worth as the holding of additional money does. This will be the case where issuence of bonds increases the total volume of public debt. However, new bonds may replace old ones, and there may be no net increase in people's holding of bonds. In this situation, holding of "additional" bonds has no meaning. Further, rise in the rate of interest may result in capitalisation of an increasing volume of bonds. This will not allow a possible increase in the market value of total bonds outstanding.

In this regard there are two extreme cases. At one extreme, investors hold money and debt in a fixed ratio. In this situation there will be no increase in the total debt and issuance of bonds will affect only the rate of interest. It means capital losses for old bond holders, though new bond holders will gain. For bond holders as a group there is no change in net worth and hence no wealth

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8. Musgrave, R.A. The Theory of Public Finance, New York Mac Graw-Hill Book Co., 1959, P.538.

effect. On the other extreme, investors are indifferent as between bond and money holding. In this situation, rate of interest is not affected and total debts increase and thus wealth effect become fully operative. But actual condition fall between these extremes. Issue of new bonds will partly raise the rate of interest and the market value of total debt. Some wealth effect is bound to occur. Hence some increase in consumption is likely to occur via the Pigou effect provided that the market value of total bonds increases [9]

EFFECTS ON INVESTMENT : Debt transactions are a voluntary exchange and as such they differ from tax finance or deficit finance. Debt operations of the govt. are therefore likely to succeed if they are acceptable to investors. In other words, it must meet the evaluation that the market places upon such debt. An investor holds a portfolio of assets which includes cash, bonds and equity. "He will choose that combination of assets which seems best in view of his market appraisal and his preferences between gain safety"[10]. Cash satisfies the desire for liquidity and

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9. Op. Cit., p. 280.

10. Op. Cit., p. 543.

enables the investors to benefit from possible rise in the rate of interest. Bonds give an interest income at a fixed rate and incure him against the loss he would suffer from possible decline in interest rates. The choice between bonds and equity depends on expectations of changes in price level and not in interest. If the investor expects the price level to rise, he will prefer equity to bonds. Thus, on the one hand, there is the supply of investment assets provided by the state and the private sector, and on the other hand, there are funds seeking different forms of investment. The manner in which the total demand for investment depends on the liquidity preferences of the investors, their expectation regarding future yields and prices of securities, the money supply conditions in the market and business conditions in the economy in general. The investment pattern also depends on the expecfations of the investors regarding future business prospects, prices and changes in the rate of interest[11].

Moreover, on the whole, the proportion in which the total funds are distributed between the state and the private issues depend on the factors such as the relative rates of interest paid on these issues, the fluctuations in their prices, the preferences of the investors, that is whether they prefer safer investment and stable income or are ready to undertake more risk and desire higher though

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11. Op. cit., p. 544.

fluctuating incomes and their expectations regarding future changes in various economic factors. If we concentrate on two alternatives only, cash and bonds and disregard equity just for the sake of simplicity to see the effect of an increasing sale of bond on the rate of interest. Just as investors are willing to absorb an increased supply of money only at a reduced rate of interest, similarly they are willing to absorb an increased supply of 'consols' only at an increased rate of interest". In order to illustrate this Musgrave uses the following equation.

$$i = \frac{u}{M_a} \quad \frac{1-B}{B}$$

where, i = market rate of interest

u = yield on consols, that is rate of interest on bonds

M_a = supply of asset money

B = the fraction of the claim that people want to hold in debt (D)

In above for formula, if suppose M_a is constant, an increase in u raises i because investors are willing to absorb the increase in u only at a higher i. If u and M_a increase at the same rate, there is no effect on i, if B remain constant. Simply we can state that the sale of govt. bond may reduce the demand for corporate securities. This will push up the interest rate making the sale of existing equity share more costly to existing owners. This will be so under the assumption of invariable money supply. If, however, the central bank raises the supply of money through open market operations, interest rate may not rise. So far we have just taken two assets. For complete analysis we have to consider a broader choice of assets. In general, investors may wish; (a) to substitute money or debt for goods, if they expect the price level to fall; (b) to substitute public debt for private debt as a default risk of private debt rises; (c) to substitute debt for money if the rate of interest is expected to fall; and (d) to substitute money for debt in order to meet contingencies in an imperfect credit market. From the above we may conclude that the issue of bonds if likely to have restrictive effect on investment while the rate of interest raises. These restrictive effects will be severe if the rate of interest responds sharply and in this case expansionary wealth effect on consumption will be small or nil. However, when the expansionary wealth effects on consumption are substantial as will be in the case if public debt increases, the rate of interest will not be so responsive and the restrictive effect on investment will be slight.

Further, investment may be affected in other ways as well besides the change in the rate of interest and wealth effect. Adverse effect on investment will be caused if securities are sold to commercial banks and other institutions which have no excess reserves. It is for the reason that such sale will reduce the volume of funds that might be available for loans to business[12].

<u>OTHER EFFECTS OF PUBLIC DEBTS</u> : Since public borrowing is voluntary it is more expansionary than taxation. It is generally considered that people would purchase bonds not by curtailing consumption as in case of taxation but by reducing saving or by dissaving. Thus a budget deficit means net injection of purchasing power into the economy. Further more, a massive conversion of interest bearing debt into money would lead to inflation. However, if business community, regard the public debt as a source of potential economic instability, their willingness to under take real investment will be lessened. A large debt may discourage expansion of economic activity because of the fear of high taxes in the future and the realization that the large debt may preventborrowing for urgently needed local improvements.

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12. Prest, A.C. Public Finance in Underdeveloped Countries, London Weidenfeld and Niealsen, 1962.

Further, opponents of large public debt maintain that this would lead to redistribution of income toward greater inequality over time as taxes are collected to pay interest to bond holders, since govt. bonds are likely to be held to the greater extent by upper income groups. This effect may be to increase saving and reduce consumption. But this view cannot be accepted without modifications. Under conditions of war economy, there is need to curtail consumption. "This may render it necessaryto obtain a larger share of total proceeds from the lower-income groups than seems desirable on the g grounds of distributional consideration[13]. War-time withdrawls from the lower income groups may take the form of forces loans and subsequently, these may be repaid by transfer from upper income groups. Thus loan finance may serve as a means of intertemporal redistribution between income bracket, as well as means of intertemporal shifts between generations". In another situation the relationship between the income structures of the tax-payers and those of bond holders is to be considered. If these structure as such that there is transfer of resources from the upper income grcups to lower-income groups redistribution of income will be towards greater equality. In opposite case, inequality would be aggravated. As A.H. Hansan States, "In so far as the govt. can from small savers, an increase in the public debt will not prove favourable

13. Op. cit., p. 567.

to an equitable distribution of wealth. But if the growth in the public debt is very rapid, it will not be possible for relatively small savers to take any large proportion of new securities issued. They will oe absorb by rich and well to do and by large corporations.A rapid growth in public debt, is, therefore, likely to intensify inequilities in wealth distribution[14]. Another important effect of loan finance is the reduction a in fluctuation in the level of taxation, i.e.tax revenue income ratio due to fluctuation in the level of public expenditures. Taxation must not be subject to uncertainty since that may cause grave damage to the economy, but public expenditure, is however bound to be subject of undercertainty such as flood, femine, war, etc. Hence, "Intermittent loan finance may be desirable where frictional effects of taxation become an increasingly serious problem as the level of taxation rises"[15]. Finally, large interest obligations lessen the ability of the govt. to finance other governmental activities specially where tax potential are limited.

The retirement of public debt has effects opposite from those of borrowing. Bond holders receive money in exchange for their bounds; though they could increase their consumption, they are more likely to put the funds into other

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14. Hansen, A.H.Fiscal Policy and Business Cycle, New York, N.W.Norton & Co., 1941, p. 179.
15. Op. cit., p. 567.

securities and, as a consequence, securities prices will rise and money capital become more readily available for business investment and their use depend upon the general economic condition. The money for retirement, if simply created, there will be no repressive effect on consumption or investment and the total spending in the economy will rise. But as if it more commonly believe that debt is to be retired from the tax-revenues, consumption will be reduced. The net curtailment in spending from the programme of debt retirement is almost certain to reduce total spending in the economy. Elumination of debt has separate effect present level of tax will increased but future tax rate will reduced[16].

THE BURDEN OF PUBLIC DEBT :

The burden of public debt controversy is one of the oldest subjects of academic discussion. The controversy relates mainly to the concept of the burden of public debt and to shifting of the burden to future

16. Buchanan, J.M., Public Principles of Public Debt, Homwood, Illinois Rechard, D.C. Irwin Inc., 1958.

generation. The classical view, under the "self liquidating" or "pay-as-you-use" approach maintains that any loan which is incurred for a purpose that does not yield any direct monetary return imposes a burden on the society because additional taxation is needed to meet interest costs and to repay the principal. The conventional view further maintains that public borrowing diverts savings for public use and thereby starves the private sectors. It also holds the view of the shifting of debt burden to future generation[17]. The concept of the burden of public debt is an extremely vage one, yet, a distinction may be drawn between financial burden or primary burden and real burden or secondary burden. When a debt is incurred by the govt. the level of taxation in the economy has to be increased to meet the interest charges so long as debt exist. To the extent of the increase in the tax level, the income of the people is transferred to the govt. The consequence loss in the income of the people may be called financial burden of public debt[18]. As David Mcc Wright observes, "The financial burden of public debt is to be measured by the effects of the interest charges and the taxes levied to meet them. The relation which the taxes for

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17. Op. cit., p. 285.
18. Taylor, P.E. The Economics of Public Finance, New York Mac Millian & Co. 1949.

interest bear to the national income is the question of primary importance[19]. The concept of burden is some time explain interms of the notion of abstinence or pain cost doctrine and opportunity cost. Public borrowing reduces the availability of private goods and thus it is also known as 'real burden'. Similarly, on the basis of principles of opportunity cost, it is said that the public debt entails a burden because, when a loan is raised by the govt. people are prevented from putting their resources into other purpose the marginal productivity of which might be more. Further the higher level of taxation caused by the rising public debt may have some repercussions on the economy in the form of adverse effects on the capacity and willingness to work and the capacity and willingness to save[20].

The Keynesian approach maintains that public debt for the purpose of generating effective demand is no burden because it would activate idle saving in the private sector and generate income and employment. This is the line taken by A.P. Lerner. He advocates repayment of debt during inflationary period[21]. Domar has gone a step further and integrated

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19. Wright, D. Mcc. "The Economic Limit and Economic Burden of an Internally Held National Debt.

20. Op. cit., p. 103.

21. Lerner, A.P. Economics of Employment(New York Mac Graw-Hill Book Co., 1955), p.274.

the Keynesian view with the rate of growth of the economy. In his view, public debt is a burden only when the rate of growth of economy fails behind the rate of increase in interest costs[22].

However, the burden of public debt refers to costs or disadvantages that are imposed upon the economy when public expenditures are loan financed. This cost will be zero if it grows during a period of large scale unemployment. It is for the simple reason that such debt, via its expansionary effect, puts idle resources back to work. This increase the national output which is net gain to the society. From the point of view of stablization policy loan financing of public expenditure during a period of full employment is unappropriate. A large public debt necessitates payment of interest in substantial amount, which may be possible only through increase in taxation. "Taxes may tend to dampen incentives to bear risk, to innovate, to invest and to work. In this indirect way the existence of a large debt can impair economic growth"[23]. Thus burden of debt may be measured by the amount of strains and frictions imposed on the economy as a result for additional taxation needed for repayment. In the

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22. Domar, E. "The Burden of Debt and National Income", in Reading in Fiscal Policy. (London George Allen and Irwin Ltd), 1955, p. 500.

23. Campbell R.Mc Connell, Economics, McGraw-Hill Book Co., (International Student Edition), 1969, p. 273.

words of Ratchford, "an internally held public debt is a burden even when taxes are paid to service the debt in the same ratio as the bonds are held. This true because of the frictions of Levying and collecting taxes and because of the difference in the subjective effects of paying taxes and receiving interest. Most important, however, is the fact that such a debt is a burden because, when joined with a progressive tax system it substantially restricts investment and thus lower national income"[24]. The payment of interest and principal on public debt may increase income inequality. Bond holders belong generally to the middle and upper income groups, while tax revenue comes evenly from all income groups in rich countries and proportionately more from the lower groups in poor countries. Thus the net result of debt repayment is greater income inequality.

However, the existence of a large public debt in itself is inflationary for two reasons, first, govt. bonds are highly liquid assets. Possession of such bonds makes the lenders feel wealthier This lead to greater consumption and shift the consumption schedule upward. In a situation of

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24. Rathford, B.U., "The Burden of A Domestic Debt". Reading in Fiscal Policy (London George Allen & Unwin Ltd. 1955), p. 455.

full employment this shift will be inflationary. Second, conversion of govt. bonds into cash is very easy and involves little risk or loss. Such bonds act therefore as a potential backing of purchasing power and thus may add to inflationary pressure in a period of full employment. The change in the size of public debt is more important than the absolute size of the existing debt. A small increase in public debt during full employment may have more inflationary impact on the economy than a large volume of existing debt. Moreover, the expansionary effect of public debt is not always undesirable, as in case of recession[25].

It is often said that borrowing shift the burden of governmental activities to future generations, since those generations will be assessed higher tax to pay the interest and principal. Economists generally regard the argument as invalid, for future generations will inherit both the bonds and the obligations to pay them and collectively will be neither richer nor poorer than if debt had not been incurred, except as a result of the difficulties incident to the debt and its retirement. Regardless of the methods of financing, the real cost of any governmental activity, war or otherwise, is born in the form of reduced consumption and investment and harder work or the like during the period in which it

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25. Op. cit., p. 273.

is carried on. The only burden on the future is that arising from the depletion of natural resources or slower rates of investment and these are not affected by methods of financing[26]. Several economists have pointed out that this reasoning ignores one significant point that is, if governmental activities are financed by borrowing, consumption will be reduced less and saving more than with tax-financing and also because of existence of the debt, persons will continue to consume more and save less. Assuming full employment, the rate of capital formation will therefore be less than with tax financing; future generations will inherit a some what smaller stock of capital goods, and percapita real incomes will be some what less than they would have been if tax financing instead of borrowing had been used[27].

Some economists have the doctrine that burden, even apart from its effects on capital formation, is not shifted forward to the future. They argued that burden can be meaningfully viewed in terms of individual satisfaction only. In the period in which borrowing occurs, the purchasers of govt. bonds obviously suffer no burden, in the sense of loss of personal satisfaction, because they bought the bonds voluntarily and having exchanged money for the bonds, presumbly regard

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27. Ferguson, James M.(ed.), Public Debt and Future Generation, Chapel Hill : The University of North Caroline Press, 1964.

themselves as better off. But in future, when the debt is repaid, tax payers will suffer a loss since they must pay larger amount of taxes than they otherwise would and will therefore lose satisfaction, while the bond holders will experience no net increase in satisfaction since they will merely re-exchange the bonds for money. Thus a net decline in personal satisfaction will have occurred in the future generation and the burden will actually have been shifted to the future[28].

However, the difference between these two lines of reasoning hangs upon the definition of burden. If burden is defined as the reduction of output in the private sector of the economy, when resources are transferred to the public sector, obviously the burden occurs at a time of governmental activities are undertaken. If burden is defined in terms of individual sacrifies, the burden occurs in the future. The first definition is useful in stressing the fact that resources cannot be pulled from one generation to another (except through the effect on the rate of capital formation) and that therefore borrowing does not make real income greater in the present and less in the future. The second definition is relevant if persons believe that borrowing does shift the burden to the future, for then, during the period of borrowing, fewer private sector goods will be available for consumption and capital formation, but

28. James M. Buchana, op. cit., p. 6.

individuals will experience an equivalent increase in their personal wealth in the form of govt. bonds. Thus as long as they disregard the future tax liabilities created by the borrowing they do not feel a burden.

The phenomenal increase in India's public debt has been a subject of acrimonious debate in recent years specially in the Parliament and State Legislatures. The members of Parliament and State Legislatures and the Parliamentary Committees such as Estimates Committee and Public Accounts Committee have several times stressed the need for fixing a statutory limit to govt. borrowing. The opinion is based on the belief that the govt. has been excessively and that the burden of public debt is increasing day by day. Article 292 of the Indian Constitution has empowered the parliament to fix a statutory limit within which the govt. can borrow. But no law has been enacted by parliament so far to fix statutory limit.[29] In this regard Finance Ministry stated, "in all circumstances govt. are satisfied that no real advantage would be secured by prescribing statutory limits on govt. borrowing"[30] and a number of arguments have been extended. However, whether the existing size of public debt is a burden is to be examined

29. Report of the Estimates Committee (Twentieth Report; Second Lok Sabha), Cited in Report of the Public Accounts Committee, 1964-65 (New Delhi, Lok Sabha Secretariate April, 1965 p. 41.

30. Ibid, pp. 10-11

taking account of all the relevant factors. The burden of public debt cannot be considered in isolation, it should be assessed in relation to ntional income, govt's. revenue and expenditure pattern of ownership of public debt. The cost of public debt should be weighed against the benefits of public debt and in this context it is essential to examine to what extent public debt has led to asset creation and to what extent it has contributed to the growth of Indian economy. Here, we will take internal public debt of govt. of India and examine all facts pertaining to cost and benefits.

Probably the most viable determinent of the intensity of debt burden is the ratio of public debt to national income, their relative magnitudes should be taken into consideration. Table shows India's internal public debt position in relation to national income (G.N.P.). The ratio of internal public debt to G.N.P. was only 17.88% in 1970-71. It increases to 22.63%in 1980-81, 27.24% in 1985-86, 29.16% in 1990-91 and remains some what static in 1994-95. If the rate of growth of public debt is greater than the rate of growth of national income, the magnitude of the burden of debt may be said to be increasing relatively, and declines in opposite case. Between 1970-71 and 1994-95, India's internal public debt increased by 34.81 point whereas the G.N.P. increased only by 2071 point. What is the matter of real concern is the low rate of growth of national income rather than rapid increase in the public debt.

Table-5.1

Relationship between population & Internal Public Debt.

Year	G.N.P. at Current Price Rs. in(Crores)	Population in millions	Percapita Income in(Rs.)	Outstanding Internal Public Debt Rs in (Crores)	Percapita Internal Public Debt in Rs.	Outstanding Internal Public Debt as a Percentage of GNP.
1970-71	42879	541	792.59	7666	141.70	17.88
1975-76	78506	607	1293.34	13899	228.98	17.70
1980-81	136358	679	2008.22	30864	454.55	22.63
1985-86	260814	755	3454.49	71039	940.91	27.24
1990-91	527989	839	6293.08	154004	1835.57	29.16
1991-92	606722	856	7087.87	172750	2018.11	28.47
1992-93	693525	872	7953.27	199100	2283.26	28.70
1993-94	786433	888	8856.23	245712	2767.02	31.24
1994-95	931016	904	10298.85	274563	3037.20	29.49

Source : Reserve Bank of India, Report on Currency & Finance (Various issues), Economic Intelligence Services : Public Finance Related to Centre & States, June, 1996 (CMIE)

The financial load imposed on the budget is measured by the annual interest payment required. The budgetary burden becomes more meaningful if the percentage of interest payment

Table-5.3 - Burden of Public Debt in terms of interest(Rs.in Crs

Year	Interest Paid on T.P.D.	Interest Paid on I.P.D.*	% of Interest payment on I.P.D.to T.P.D.	G.N.P. at Curr. (M.P.)	% of Interest Payment on I.P.D. to G.N.P.
1970-71	606	-	-	42879	-
1975-76	1228	-	-	78506	-
1980-81	2604	1369	52.57	136358	1.00
1985-86	7512	3856	51.33	260814	1.48
1990-91	21498	9814	45.65	527989	1.86
1991-92	26596	11317	42.55	606722	1.87
1992-93	31075	13541	43.57	693525	1.95
1993-94	36740	15587	42.42	786433	1.98
1994-95 (R.E.)	44000	19391	44.07	931016	2.08
1995-96 (B.E.)	52000	23283	44.77	-	-

Source : Finance Accounts of govt. of India and Budget Documents of govt. of India.

R.B.I. Report on Currency & Finance (Various issues

T.P.D. = Total Public Debt
I.P.D. = Internal Public Debt
* = Market loans & Treasury Bills only
M.P. = Market Price

to national income is taken into consideration. The ratio of interest payment to national income provides a simple index of the level of tax rates required and the consequent burden on the society. Table 5.2 shows the interest payment on the internal debt in relation to national income. During 1970-71 to 1994-95 the outstanding internal debt has increased nearly 35 times, but the interest payment on Internal Public Debt has risen only by 17 times during 1980-81 & 1995-96. In 1980-81 interest payment on internal public debt was 1.0% of G.N.P. and further increased to 2.08% in 1994-95. It is clear from table that overall interest burden has increased largely, but interest on internal debt shows a marginal increment only. Though interest payment on the other constituents of internal liabilities has increased tremendiously. The burden of the debt evidently refers to

The burden of the debt evidently refers to the increase in taxation which is necessary to finance the service charges. The proportion of tax revenue obsorbed by debt services, therefore is an important factor in assessing the burden of public debt. Table-5.3 shows the percentage of interest on internal public debt to tax revenue. The ratio of interest cost to tax revenue has risen from 0.97% in 1970-71 to 32.53% in 1994-95. Over the period as a whole tax-revenue has increased by more than twenty eight times whereas the interest obligation has increased by more than 968 times. The present proportion of tax-revenue absorbed by debt services is a matter of concerned. But the more significant point is whether this diversion of funds to debt services is at the cost useful public expenditure.

Table-5.3

Relationship between tax revenue and interest(Rs.in Crs)

Year	Tax Revenue of Central Govt. (direct & indirect)	Interest Received	Interest Paid	Net Interest Payment	Net Interest Payment as % of Tax Revenue.
1970-71	3206	575	606	31	0.97
1975-76	7609	934	1228	294	3.86
1980-81	13179	1795	2657	862	6.54
1985-86	28671	4595	7512	2917	10.17
1990-91	57577	8730	21491	12761	22.00
1991-92	67361	10922	26563	15641	23.22
1992-93	74636	12487	31035	18548	24.85
1993-94	75742	14538	37500	22962	30.32
1994-95	92294	15978	46000	30022	32.53

Source : Economic Intelligence Services, Basic Statistic Relating to Indian Economy (All India) Aug.1993.

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Table-5.4

Assets and Liabilities of Govt. Rs. in Crores

Year	Total Liabilities as a result of public debt.	Total Capital Outlays & Loans Advanced	Excess of Liabilities Over Capital Outlays & Loan Advanced	% of Total Liabilities Utilised for Capital Outlays Loan Adv.
1960-61	6224	6124	100	98.39
1977-78	40,90	4090	-	100.00
1980-81	59,449	59,670	-221	-
1980-85	1,13,141	1,05,120	8,021	92.91
1989-90	2,68,192	2,09,623	58,269	78.17
1990-91	3,14,558	2,36,740	77,518	75.26
1991-92	3,54,362	2,61,478	92,884	73.79
1992-93	4,01,624	2,90,963	1,10,661	72.45
1993-94	4,77,968	3,29,876	1,47,792	69.01
1994-95 (R.E.)	5,41,329	3,60,914	1,80,415	66.67
1995-96 (B.E.)	6,00,029	3,84,276	2,15,753	64.04

Source : Budget Documents of govt. of India.

PUBLIC DEBT AND ASSET CREATION : It is said that if the rate of growth of public debt is accompanied by corresponding increase in the rate of assets-creation, the burden to public debt would be less onerous. The borrowed funds if utilised for the asset creating public project, the income of the nation is bound to be increase along with the rise in the govt.'s obligations. The volume of investment in the five-year plans would not have been what it is without public borrowing and therefore at least a part of the rise in national income might be attributed to the rise in public debt which provided funds for public investment under the plans. Table-5.4 shows the assets and liabilities of the govt. of India. In India most of the funds mobilised through public borrowing are utilised for the purpose of creating assets in public sector. For instance total liabilities of govt. of India as a result of public borrowing was estimated of the order of Rs. 3,14,558 crores at the end of March 1990-91, out of which Rs. 2,36,740 crores were utilised for creating capital assets. Thus Rs. 77,518 crores can be said to be excess liability upon the govt. Hence, it can be said that the burden of public debt upon the Indian economy cannot have adverse effects. It cannot be treated as a very heavy burden. Though there is a smooth declination in the percentage of total liability to capital outlays from 1960-61 to 1995-96 except 1977-78 and 1980-81.

CHAPTER -VI

CONCLUSION

India when it was set free from clutches of the British Rule in 1947, was in worst possible economic and social conditions. There is no need to mention the extent of backwardness, poverty and unemployment, institutional and structural drawbacks in the country at that time. After independence she started planning for economic development. It was really a bold step to undertake planned programme with large amount of expenditure in each subsequent five year plan. Though India has been very rich in natural and human resources, but there has always been problem of capital resources which are very necessary for the development purposes. Therefore, two problems stood in the way of economic development from the point of view of capital resources. First, depending on foreign capital which involved the requirement of foreign exchange. Secondly, the use of capital in best possible way so it could yield optimal out come in the field of production vis-a-vis the utilisation of other domestic resources for raising the productive capacity of the nation as a whole. It was not possible for India to complete the programme launched in a particular five year plan without adequate financial resources. Then India definetly used the resources available with the public, though they were meagre and scattered throughout the country. The people were not habitual to save and use them for productive purposes. Introducing simple saving scheme and good incentives, the behaviour of people was to be changed. The govt. has highly succeeded in attaining the goal of high rate of saving in the country. It is remarkable that our rate of saving has increased from below 5% to more than 20% during this period. We have already explained in detail of the resources collected through internal borrowing.

Since, India launched developmental programme in different plans with new strategy. Every subsequent plan involved great amount of outlay in comparision to previous plans. It means that as more resources are required for the purpose of development as more it will make the govt. dependent on the borrowing. It has been a good sign that the ratio of borrowing to the G.D.P. was very high, but the question of the use of these borrowed resources has always been the subject of controversy, specially regarding its purpose and productiveness. So far the purpose is apprehensive in budget itself, while the productivity can be explained by the rate of growth of national income, both these questions are very difficult to be answered exactly with these data. There is no doubt that borrowing played a significant role in the plan development and it eased the problem of the govt. to meet out the expenditure. As a student of economics it can be said that finance from borrowing is not always uneconomic and unprudent. It is the use of borrowed fund which is rather more important. Our study shows this aspect of borrowing, that how the dependence on internal borrowing could help the govt. to advance and go ahead in attaining the goal of the development in the country.

This study entirely encompasses internal borrowing in India. We have not covered any aspect of the external borrowing that is altogether different area of study. In the course of development both types of borrowings are important and indispensable for the developing countries like India. This study reveals the important facts about internal borrowing as follows :

1. Mobilisation of financial resources for meeting the govt. expenditure incurring on developmental activities has been a problem of the govt. of India. In this context the role of debt are raised though they are paid leving different taxes so on so forth. But taxation is assumed to be limited in the beginning Taxation depends upon the capacity to pay, if the taxes are levied more than what the capacity of people to pay the taxes, it would be quite irretional and might have the negative economic effects in the country. Therefore in the search of additional funds the govt. has no alternative but to relay upon borrowing as much as it is managable, economically viable and productive. The whole

process of borrowing is voluntary. Means to raise the funds through borrowing the source of earnings hardly involve any risk to creditors due to a guarantee of interest payment and repayment of principles at the time of maturity as well. Therefore the study has been made on the different aspects of borrowing. It shows that the ggovernment succeeded to a great extent to achieve the goal of borrowing and thus collected handsome amount of money and used it for financing plan expenditure. Borrowing as a source of financing the plan expenditure increased from 35.9% in the IVth five year plan to 51.2% in VIIIth five year plan.

2. Internal debt was preferred to external debt as much as possible although the external borrowing became indispensable under the foreign trade situation. Keeping all the merits of internal debt in mind - its raising, repayment and structure of interest rates etc. The study has been made to reach a certain conclusion on its feasibility and usefulness.

3. There has been limited scope for mobilising resources through taxation by the union govt. In the Constitution of the govt. of India, central govt. is empowered to levy income tax and corporate tax as the direct taxes and excise and custom as an indirect taxes. The base of direct taxes has

been narrow and thus amount realized has also been low. They contributed about 20% of the total tax revenue of the govt. On the other hand, exise duty and customs are choosen for raising maximum possible tax revenue, but custom duty had some bottle-necks in the import and export and excise duty causes inflation in the country. Deficit financing though most easy but its ultimate consequences are very uneconomic and unhealthy for sustained economic growth. From the point of view of preventing further adverse effects the efforts were made to contain deficit financing so we have come again to debt financing for additional resource mobilisation. Justification for debt financing of development project has been main focus. The study has been made in the light of the important principles namely the principle of pay-as-you-use finance and the principle of inter-generation equity are followed when public projects are loan financed. These principles supply keys to raise funds through internal borrowing under subsequent plans. Internal borrowing helped the country to made additional investment and increase the pace of economic development. Such benefit of growth would certainly way out the burden of public debt to a great extent. It is obvious from the ratio of internal debt to the volume of national income.

4. In recent years it has become the topic of general discussion in and outside of parliament, that India is heading towards 'debt-trap'. In our study the statistics regarding the trend and magnitude of public debt, specially internal debt has been especially highlighted. It is clear from the data that present outstanding internal public debt of India is about only 30% of G.D.P. which is less than a number of developed and developing countries of the world. For this purpose it is better to consider the ratio of internal public debt to G.D.P. which was about 17.88% in 1970-71 has increased to 30% in 1994-95. During this period internal debt in absolute term has increased about 35 times and national income increased by 21 times. Though the picture of gross public debtposes serious problem and consequently interest payment on it. If outstanding liability is not reduced substaintially by liquidating debt financed assets in the public sector there is a possibility of govt. falling into a 'debt-trap'.

However, our study reveals that capital receipts have not exclusively utilised for development purposes creating assets in the nation. A good percentage of capital receipts has been used to meet the revenue expenditure which mostly exceeded the revenue receipts. If total receipts had completely been utilised for development purposes meaning that for creation of assets, economic scenario of the country would have certainly been far better. In other words the same problem may be highlighted in terms of fiscal crisis of the central govt. which reflects the acute financial problems of the public sector. If the investment in the public sector were more remunerative or the govt. had not borrowed heavily to invest in public enterprises, the fiscal and the internal debt situation would not have so matter of concern. The states have also not paid any heed to the centre's warning on high level of revenue expenditure without commensurate resource mobilisation. The State Govts. should frame a definite programme for a phased reduction in their revenue deficits for showing improvement in savings. Therefore it is very important at this stage for central and state govts. that the capital raised through the budget should utilised very consciously.

In our country it is very small class who are in position to buy bonds, securities etc., offered by the govt. to borrow from the market. But those who are not in position to spare funds for financial investment are tempted to it. It might make the people miser and forced themselves to abandon the necessary facilities of life. In the country where efficiency of man power has already been affected due to ill health. Therefore the study has also taken this view point. This might not help to change consumption behaviour as such that there should be good link between industrial sector and agriculture sector. The interdependence of these sectors for using the product of each sector from the view point of balanced economic growth. Some times it strikes to the mind why the demand for industrial goods have fallen specially during this period. The farmers are not yet fully independent to finance the purchases of the product of industrial sector. The country needs a sustained effort to develop the agriculture sector in order to bring it at par with industrial sector.

Most of the public sector enterprises (PSEs) have run in the losses. Such trends speak themselves the scares financial resources raised from the borrowing have not been used rationally. It seems that they have been used below optimum level. It is suggested that when govt. prepare a separate capital budget it should be given due respect to the purposesof using loanable funds in most efficient manner in order to avoid any wastage of the scares resources. Secondly immediate action should be taken either to bind up or to revitalise the sick units in the public sector. Thirdly the necessary basic needs of a common man should be given first priority provided utilising these resources within the society. It may serve two ways first, what govt. borrows from public should specially be used for their betterment and secondly, consumer-cum-lenders should be benefited by the additional income in the form of interest. If the common minimum programme is run with this thinking, it would certainly encourage the people and helpful to the country. We should launch such programme to be called, "Debt financing Common Minimum Programme." This programme will be carried involving both classes of society. Those who are providing loanable funds to the govt. for this purpose mostly belong to richer section of the society and the class for which the programme is to be launched belong to the poorer section of the society. There would certainly be humanitarian consideration behind this scheme. Indirectly the richers may serve the cause of huminity without forgoing much their economic interest while poors may not pose any danger to the nation because in the words of Uthant, U.N. Secretary General, proclaimed "Poverty any where in the world is "a danger every where in the world", no stone should be left unturned. The goal of economic prosperity in nation is attained using any means of financing such plan.

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